

AR92

ONE CLIENT, ONE BANK

2010
ANNUAL REPORT



**NATIONAL
BANK**

FINANCIAL GROUP

HIGHLIGHTS

	2010	2009	% change
Operating Results			
<i>(millions of dollars)</i>			
Total revenues	\$ 4,278	\$ 4,131	4
Total revenues adjusted for non-controlling interests ⁽¹⁾	4,273	4,133	3
Net income	1,034	854	21
Return on common shareholders' equity	17.0 %	15.6 %	
Per Common Share (dollars)			
Net earnings – Basic	\$ 5.99	\$ 4.96	21
Net earnings – Diluted	5.94	4.94	20
EXCLUDING SPECIFIED ITEMS⁽²⁾			
Operating Results			
<i>(millions of dollars)</i>			
Total revenues	\$ 4,289	\$ 4,309	–
Total revenues adjusted for non-controlling interests ⁽¹⁾	4,284	4,311	(1)
Net income	1,084	1,061	2
Return on common shareholders' equity	17.7 %	19.0 %	
Per Common Share (dollars)			
Net earnings – Basic	\$ 6.30	\$ 6.25	1
Net earnings – Diluted	6.25	6.22	–
Per Common Share (dollars)			
Dividends declared	\$ 2.48	\$ 2.48	
Book value	37.59	33.43	
Stock trading range			
High	67.87	62.08	
Low	54.45	25.62	
Close	67.13	56.39	
Financial Position			
<i>(millions of dollars)</i>			
	October 31 2010	October 31 2009	% change
Total assets	\$145,301	\$132,138	10
Loans and acceptances ⁽³⁾	63,134	58,370	8
Deposits	81,785	75,170	9
Subordinated debentures and shareholders' equity	9,241	8,494	9
Capital ratios – BIS, according to Basel II			
Tier 1	14.0 % ⁽⁴⁾	10.7 % ⁽⁵⁾	
Total	17.5 % ⁽⁴⁾	14.3 % ⁽⁵⁾	
Capital ratios – BIS, according to Basel I			
Tier 1	12.1 %	11.5 %	
Total	15.6 %	15.2 %	
Impaired loans, net of specific and general allowances	(267)	(233)	
As a % of loans and acceptances	(0.4)%	(0.4)%	
Interest coverage	9.03	8.04	
Asset coverage	4.48	4.19	
Other Information			
Number of common shares at year-end <i>(thousands)</i>	162,772	161,201	
Number of common shareholders of record	23,598	23,970	
Market capitalization <i>(millions of dollars)</i>	10,927	9,090	
Assets under administration and assets under management <i>(millions of dollars)</i>	231,470	192,551	
Number of employees	18,322	17,747	3
Number of branches in Canada	442	445	(1)
Number of banking machines	869	866	–

(1) Adjusted for gains or losses mainly attributable to third parties.

(2) See *Financial Reporting Method* on pages 18 and 19.

(3) Net of securitized assets.

(4) Calculated using the AIRB Approach.

(5) Calculated using the Standardized Approach.

MESSAGE FROM THE PRESIDENT AND CHIEF EXECUTIVE OFFICER



Louis Vachon
President and Chief Executive Officer

During fiscal 2010, National Bank once again delivered solid financial results while continuing to invest significantly in its future.

Diluted earnings per share of \$6.25, excluding specified items, surpassed the record performance achieved in the previous year. Adjusted return on equity reached 17.7%, on par with the top-performing Canadian institutions.

We maintained the superior quality of our credit portfolio and ended the year with the lowest loan loss ratio, in both absolute and relative terms, of any Canadian financial institution. Our Tier 1 capital ratio was 14.0%, also placing the Bank among industry leaders, in both Canada and globally.

Consecutive years of strong financial results have positioned the Bank favourably with respect to the new capital standards established by the world's bank regulators in the wake of the recent global financial crisis. Following careful analysis of the new rules and extensive consultations with Canadian authorities, we have determined that the Bank meets the stricter requirements. Having gained clarity on this critical issue, it was possible to develop a comprehensive capital management plan which was presented to, and approved by, the Board of Directors.

We are proud to be the first major Canadian bank to increase dividends in the aftermath of the financial crisis. Effective with the regular first quarter 2011 payment, the Bank's quarterly dividend will be \$0.66 per share, an increase of 6%. The Board of Directors also approved a share buyback program for up to 3% of its common shares. In addition, the Bank will maintain a dividend payout within its target range and strong capital ratios.

“WE ARE PROUD TO BE THE FIRST MAJOR CANADIAN BANK TO INCREASE DIVIDENDS IN THE AFTERMATH OF THE FINANCIAL CRISIS.”

Performance drivers

Our fiscal 2010 results undoubtedly benefited from a favourable economic environment in Canada, marked by a strong rebound in employment, particularly in Quebec, our largest market. They also reflect the strength of our franchise as a super regional bank and the sound diversification of our business mix. We are convinced, however, that the main driver of our strong performance during the year was the successful deployment of our long-term strategy.

Under our strategy, adopted in 2008, we are transforming our organization to be a leader in client experience with the ability to provide best-in-class financial advice, solutions and service to our clients, regardless of their point of entry into the Bank. The central component of this strategy is our *One client, one bank* initiative.

Phase I of our strategic plan, the alignment of distribution and operations along client needs, was completed during 2010. It involved organizational changes in line with our client-centric approach and the addition of over 300 client-facing positions in Personal and Commercial Banking. New guidelines were put in place to facilitate and promote referrals among our three business segments. Thousands of branch employees participated in training activities focused on sales and service to deliver a consistent high level of client experience across our network.

We also made a major commitment to invest in our physical network, which has already resulted in 93 branch renovations and relocations over the past two years as well as the replacement of all our automated banking machines. An additional 59 branch upgrades are planned for fiscal 2011, bringing the three-year total to 152 branches.

With our new distribution model and greater client focus, the Bank gained momentum throughout fiscal 2010.

- Personal and Commercial Banking led the way with revenue and net income growth of 6% and 22%, respectively, compared to the previous year. Loan volumes increased 10% and the Bank gained market share in Quebec, particularly in commercial lending.
- Wealth Management resumed growth in revenues and net income after two challenging years. Our new offering in the high-net-worth segment exceeded our expectations, and we achieved positive momentum in other key performance indicators.
- Financial Markets generated good profitability despite volatile trading conditions and lower client activity. Revenues from fee-based and banking services remained strong, with the Bank ranking among the leaders in public and corporate debt issuance during the year.

Tight cost management also contributed to our results and remains a strategic priority. In this regard, it will be recalled that as part of Phase I of its strategic plan, the Bank achieved significant recurring annual savings through efficiencies in corporate units. Going forward, we will strive to generate higher revenues by building on the momentum generated in fiscal 2010 while carefully monitoring our costs.

Next steps

We are now in Phase II of the implementation of our strategy, with good initial progress made in the analysis and planning of the next steps. Our focus in this phase is the simplification of internal processes and the implementation of an advanced sales and service platform that will support front-line employees in forging stronger client relationships. Successful execution will provide the Bank with market leading capabilities in improving both client experience and productivity.

Because this is the most sweeping transformation of business processes we have ever undertaken, we are exercising great care in the implementation process, with a particular emphasis on transparent communication with our employees. We are also working with implementation partners who are global leaders in their fields—SAP for the software and Accenture and CGI for the integration—to assist us in the execution of this strategic project.

Our objective is to complete the implementation of the new platform over a two- to three-year horizon. Regardless of the time to full completion, strategic business advantages and efficiency gains will be realized as each new business process is implemented.

Our strategy also comprises a strengthening of management practices to instil a culture of collaboration, accountability and performance at all levels. We are eliminating silos and organizational boundaries and promoting the exchange of best practices. Our recent successes are helping to build trust and confidence among our different divisions and business units, paving the way to greater teamwork and a seamless organization that places client satisfaction at the top of its priorities.

Looking ahead

We believe that our long-term focus will serve us well in an environment of slow economic growth and intense competition at home and continued volatility in global financial markets. We see Canadian GDP growth in the 1-2% range for the next few years and a more restrictive fiscal environment as the federal and provincial governments begin to tackle the deficits incurred to support the economic recovery.

In such an environment, our significant investments in people and distribution over the past two years position the Bank to improve client service and gain market share. By maintaining strict cost management, we aim to gain operating leverage and allow the Bank to provide competitive returns to shareholders on a sustained basis while continuing to invest in its future.

This includes investments in Phase II of our strategy, selective acquisitions that meet our criteria and strong emphasis on building the Bank's brand through advertising, sponsorships and other activities. As in years past, the Bank will continue to fully assume its social responsibility through its donations and sponsorships in the areas of education, health, the arts and community outreach.

Acknowledgements

Our results show clearly that the *One client, one bank* initiative holds tremendous promise for our Bank. Phase I was executed according to plan, and I wish to commend my colleagues in the Office of the President for their leadership. We have undertaken to transform the Bank and thus far management and employees have demonstrated that we are up to the task.

As we continue to move ahead in Phase II of the transformation, I am comforted in the knowledge that the vast majority of the Bank's more than 18,000 employees understand and endorse our strategic direction. They recognize that our client-centric strategy will make the Bank a stronger competitor and their work more interesting while creating more career opportunities. I also take great pride in knowing that the employees have recognized the Bank as one of the "50 Best Employers in Canada 2011." On behalf of the executive management team, I wish to acknowledge their high level of engagement and thank them for their hard work and contribution to the Bank's success.



Louis Vachon
President and Chief Executive Officer

SELECTED ACHIEVEMENTS

PERSONAL AND COMMERCIAL

Following significant organizational changes to align distribution with client needs, the Bank created over 300 client-facing positions. The year 2010 was a year of achievements for Personal and Commercial Banking.

The number of Personal Banking clients reached 2.3 million, and Commercial Banking clients numbered approximately 130,000 for 2010.

The Bank achieved growth in loan volumes and increased its Quebec market share in commercial lending.

Under its branch modernization program, the Bank renovated or relocated 54 branches in 2010, with an additional 59 upgrades planned for 2011, bringing the three-year total to 152 modernized branches.

The Bank began to implement, to its Personal and Commercial Banking activities outside Quebec, key elements of the *One client, one bank* approach.

WEALTH MANAGEMENT

Notable progress was made in forging effective collaboration between the Bank's business units and leveraging distribution channels in and outside Quebec, as well as in the full line-up of retail investment offerings to address the needs of each of the Bank's client segments.

National Bank Private Wealth 1859, created to serve the high-net-worth segment, achieved ambitious targets for number of clients and assets under management. Referrals from National Bank Financial investment advisors and Personal and Commercial Banking contributed significantly to this success.

For the Partnership business, a total of 25 new distribution agreements were signed with various brokers/dealers, contributing to volume growth in the Personal and Commercial business segment.

The Bank enhanced its offering with changes to certain mutual fund families and the introduction of new products managed by external portfolio managers.

The Bank's Managed Portfolios and Meritage Portfolios each surpassed the \$1 billion mark in assets under management.

FINANCIAL MARKETS

By focusing on the internal alignment of resources along client lines while emphasizing teamwork and collaboration with other Bank divisions, the Financial Markets segment was well-positioned to address the challenges of an increasingly competitive environment.

The Bank brought together expertise in fixed income, equities, derivatives and foreign exchange operations onto a state-of-the-art trading floor in Toronto.

The Bank led or joint-led 45 deals for more than 15% of all public sector debt issuance, moving up to fourth position in 2010 in the Thomson Reuters underwriting league tables from sixth in 2009.

The number of corporate and commercial clients actively using interest rate, energy and foreign exchange risk management products experienced double-digit growth in 2010.

The Bank was the designated broker for 37% of all exchange-traded funds (ETF) listed in Canada and maintained a top quartile position in secondary market trading of ETFs.

CORPORATE UNITS

The Bank's loan loss ratio in 2010 was the lowest of any Canadian financial institution, in both absolute and relative terms, reflecting the rigorous application of prudent lending policies and practices by employees in all three business segments, under the oversight of the Risk Management Group.

The Operations unit entered 2010 organized into three groups, each dedicated to supporting the Bank's three business segments to achieve higher productivity, business growth and improved client experience.

The Bank selected its software and integration partners for a new customer relationship management platform and completed initial steps toward its implementation.

The Bank implemented and prepared for fundamental regulatory changes in a number of areas, including accounting standards and capital management.

BRANDING

The Bank introduced a best practices program for employees throughout its business units geared toward promoting a client-centric approach and increasing overall results.

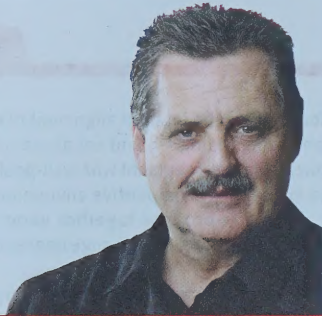
The Bank's measurement of overall client satisfaction evolved into a loyalty measurement across most of its business segments.

The Bank launched *Clearfacts.ca*, one of the leading private Canadian initiatives to promote financial literacy.

The Bank became a presenting sponsor of the Montreal Canadiens hockey club with its corporate signature prominently displayed at the team's home rink in Montreal.

ONE CLIENT, ONE BANK

“National Bank is my choice because I have full confidence in the ability of its staff to deliver banking services that meet my exact needs.”



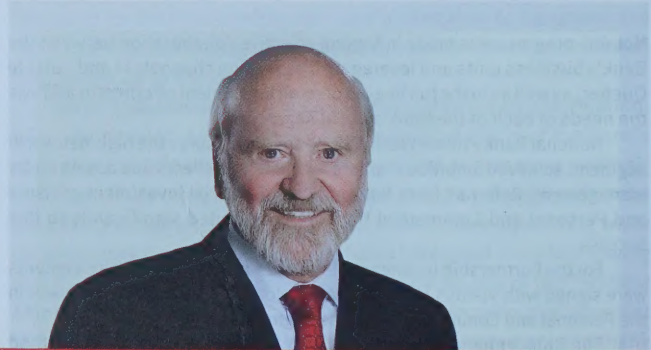
Paul Barbeau

A National Bank client for more than 20 years, Paul Barbeau values the relationship of trust that has developed over time, in addition to the personalized banking services he knows he can count on. Mr. Barbeau's satisfaction is such that he is always recommending the Bank to family members, friends and business associates.

PERSONAL BANKING

Personal Banking's mission is to deliver a full range of financial products and services, from everyday transaction solutions to mortgage loans, consumer loans, credit cards and a range of savings and investment options to suit every need. In addition, through specialized subsidiaries, the Bank also offers comprehensive insurance solutions, including home and automobile coverage, life and health insurance, as well as credit protection on these loans.

“National Bank aims to provide each client with the best financial solutions for them, and that's how I believe a business relationship should work. The Bank has stood by me through all of the major initiatives undertaken by my companies over the past 20 years.”



Jeannot Harvey, P.Eng., M.B.A.

COMMERCIAL BANKING

Commercial Banking serves the needs of small and medium-sized enterprises and large companies across Canada. The Bank offers a full range of services, including credit, deposit and investment solutions, international trade services such as trade finance and foreign exchange, payroll, cash management, insurance, electronic transactions and complementary services. While providing financial and transactional solutions for businesses, the Bank is proactive in meeting the personal financial needs of entrepreneurs and business owners/managers.

As President of Groupe Ceger, which controls a major Canadian group of four companies—Cegertec (consulting engineering), Cegerco (construction), Mecfor (equipment manufacturing) and Cegerdev (real estate development)—Jeannot Harvey strives to offer his clients total solutions through an integrated and customized approach that is dynamic, innovative and highly effective. In his view, National Bank embraces the same business philosophy. So when it was time to choose a bank that was most capable of serving his companies well, the decision was self-evident.

“One of the best decisions we made was to transfer the management of our investments to National Bank Financial Group. We are fully confident that our advisor is working with us and guiding us toward achieving not only our financial objectives, but also our life goals.”



Johanne Trottier and Jean-Louis Bélanger

Seeking strategic advice on how to manage their investments, Johanne Trottier and Jean-Louis Bélanger met with an investment advisor at National Bank Financial Group. A relationship of trust developed over the years of receiving services tailored to their needs, ranging from investment management and registered education savings plans of their children, to commercial loans and even the opening of a family trust. For more than ten years, this relationship has provided them with the highest level of comprehensive personalized service.

WEALTH MANAGEMENT

Wealth Management serves the investment and savings needs of a broad range of clients to whom it offers an array of complementary services. Investment solutions, products and specialized services are provided directly to clients or through some 775 investment advisors working in over 100 service outlets across Canada. Services provided to clients include, among others, full-service and discount brokerage services, trust services, proprietary mutual funds and fund portfolios (or wrap funds) as well as in-branch financial planning and private banking services.

“Growing our company was top priority. With the Bank’s help, we successfully added highly strategic assets and increased our presence in the Canadian food distribution market.”



Gilles C. Lachance

FINANCIAL MARKETS

Financial Markets provides corporate, public sector and institutional clients with banking and investment banking services, as well as giving its clients access to the Canadian capital markets through its fixed income, equities and derivatives business lines. This segment also offers extensive advisory services in the areas of mergers and acquisitions and financing as well as risk management products based on derivative products in the areas of interest rates, equities, foreign exchange and commodities.

Gilles Lachance, Chief Executive Officer of Colabor, an integrated food marketing and distribution network, has been a client for the past five years. He appreciates the advisory services, particularly in the areas of mergers and acquisitions, credit capital markets, and conversion to a public corporation.

OFFICE OF THE PRESIDENT



Louis Vachon
President and Chief Executive Officer



John B. Cieslak
Senior Vice-President,
Information Technology,
Sourcing and
Organizational Performance



Patricia Curadeau-Grou
Chief Financial Officer and
Executive Vice-President,
Finance, Risk and Treasury



Michael Hanley
Senior Vice-President,
Operations and
Strategic Initiatives Office



Lynn Jeannot
Senior Vice-President,
Human Resources and
Corporate Affairs



Réjean Lévesque
Executive Vice-President,
Personal and Commercial Banking



Luc Paiement
Executive Vice-President,
Wealth Management
Co-President and Co-Chief Executive Officer,
National Bank Financial



Ricardo Pascoe
Executive Vice-President,
Financial Markets
Co-President and Co-Chief Executive Officer,
National Bank Financial

The Office of the President, which is composed of the President and Chief Executive Officer and the officers responsible for the Bank's main functions and business units, is mandated to define the Bank's culture and philosophy, approve and monitor the strategic growth initiatives of the Bank as a whole, manage risks that could have a strategic impact, assume stewardship of technology, manage the officer succession process, and ensure a balance between employee commitment and client and shareholder satisfaction.

The Office of the President carries out its responsibilities as a team, thereby ensuring consistency as well as information and knowledge sharing among the Bank's business units.

OUR VISION

A FINANCIAL LEADER IN QUEBEC, NATIONAL BANK FINANCIAL GROUP IS RECOGNIZED BY ITS CLIENTS AS A GROUP THAT MEETS THEIR NEEDS AND IS EASY TO DO BUSINESS WITH.

OUR AGILITY COMPARED TO OUR COMPETITORS AND OUR EMPLOYEES' COMMITMENT SETS US APART. OUR FINANCIAL PERFORMANCE IS IN THE TOP QUARTILE IN OUR INDUSTRY IN CANADA.

OUR VALUES

CLIENT SATISFACTION

Clients are the focus of our concern and the reason for our success.

PERFORMANCE

We are oriented towards success and focused on performance. No effort is spared as we constantly strive to reach new heights, and we take pride in providing reliable and professional service.

COOPERATION AND TEAM SPIRIT

We all work towards a common goal: individual success is defined by team success.

INTEGRITY

We understand the importance of uncompromising ethics in ensuring respect for our clients and the communities we serve as well as compliance with laws and regulations.

EFFICIENCY

We demonstrate efficiency, drive and competence in everything we do.

INNOVATION

We are able to think outside the box, propose innovative products and services and develop new ways to work. We are active players in the rapidly changing world of financial institutions.

MESSAGE FROM THE CHAIRMAN OF THE BOARD



Jean Douville
Chairman of the Board of Directors

The Board of Directors is pleased with National Bank's financial performance in fiscal 2010. At a time of uncertainty in the global financial system, it is reassuring to note the quality of the Bank's credit portfolio, the strength of its capital and liquidity position, as well as its ability to generate competitive total returns to shareholders while making significant investments in long-term growth.

The Bank is in the midst of implementing its *One client, one bank* strategy, and the fiscal 2010 results are a promising indicator for the future. The Board is attentively monitoring progress and bringing to bear its collective experience in business and governance to assist management in the successful completion of this major transformation of the Bank, notably in the area of client service.

The numerous changes in regulations and existing standards during recent years have expanded the oversight role of the Board. As a result, Board members have undertaken a thoughtful examination of existing policies and practices within the Bank. In addition, they invest considerable time to understand emerging issues through presentations by management and experts on many subjects such as new IFRS accounting standards, the latest guidelines from the Basel Committee on Banking Supervision, known as Basel III, and evolving governance practices.

One of the key responsibilities of the Board is to review and assess the Bank's risk management capabilities and to ensure its activities are consistent with internal guidelines and best practices. This is an ongoing preoccupation for the Board. More recently, following the recommendations of the Financial Stability Board, the notion of risk management has been extended to compensation programs.

"AT A TIME OF UNCERTAINTY IN THE GLOBAL FINANCIAL SYSTEM, IT IS REASSURING TO NOTE THE QUALITY OF THE BANK'S CREDIT PORTFOLIO AND THE STRENGTH OF ITS CAPITAL AND LIQUIDITY POSITION."

The Human Resources Committee of the Board conducted a comprehensive review of best practices in compensation with the assistance of independent external consultants. Certain adjustments were implemented in the Bank's compensation programs to more closely align pay with shareholder return and prudent risk management, and these adjustments were communicated in detail to shareholders. Furthermore, at the Annual Meeting held in March 2010, shareholders approved the Bank's executive compensation in one of the first "say on pay" advisory votes conducted in Canada.

Another key area of focus for the Board is its succession and renewal, a process that takes into consideration a number of factors, including regulatory requirements, its Charter of Expectations for directors, and best practices. With several long-serving directors retiring in the near future, the Conduct Review and Corporate Governance Committee has been actively evaluating new candidates for nomination as new directors and maintains a permanent list of potential candidates. This committee ensures that the Board continues to benefit from diversified knowledge and experience of the highest levels in exercising its responsibilities.

In this regard, we are pleased to welcome Jill Denham as a director effective October 27, 2010. Ms. Denham brings valuable experience in financial services acquired during more than 20 years in senior executive positions with a major Canadian financial institution. Additional new directors will be appointed as currently serving directors leave their positions. On behalf of the Board and shareholders, I take this opportunity to acknowledge the important contributions of Pierre Bourgie, who stepped down in August 2010, and of Shirley A. Dawe and Marcel Dutil, who will not be seeking re-election as a director at the next annual meeting.

Heading into a new year, the Board has confidence in the Bank's future. The Bank has a clear strategy and is led by capable management. Its more than 18,000 employees are a strong team whose dedication and efforts are critical to the Bank's progress. Management and employees deserve our heartfelt thanks for making 2010 a successful year.



Jean Douville
Chairman of the Board of Directors

BOARD OF DIRECTORS

Lawrence S. Bloomberg

Toronto, Ontario, Canada
Advisor,
National Bank Financial
Director since August 1999

André Caillé ^{1-2 (c)-3}

Lac-Brome, Quebec, Canada
Corporate Director
Director since October 2005

Gérard Coulombe

Sainte-Marthe, Quebec, Canada
Partner,
Lavery, de Billy, LLP
Director since February 1994

Bernard Cyr ³

Shediac Cape, New Brunswick, Canada
President,
Cyr Holdings Inc.
Director since August 2001

Shirley A. Dawe ¹⁻²

Toronto, Ontario, Canada
Corporate Director
Director since July 1988

Gillian H. (Jill) Denham ¹

Toronto, Ontario, Canada
Corporate Director
Director since October 2010

Nicole Diamond-Gélinas ³

Saint-Barnabé-Nord, Quebec, Canada
President,
Aspasie Inc.
Director since March 1998

Jean Douville ⁴

Bedford, Quebec, Canada
Chairman of the Board,
UAP Inc.
Director since November 1991

Marcel Dutil ¹

Montreal, Quebec, Canada
Chairman of the Board and Chief Executive Officer,
Canam Group Inc.
Director since January 1982

Jean Gaulin ^{1 (c) -3}

Laguna Beach, California, United States
Corporate Director
Director since October 2001

Paul Gobeil ^{2-3 (c)}

Ottawa, Ontario, Canada
Vice-Chairman of the Board,
Metro Inc.
Director since February 1994

Louise Laflamme ¹⁻³

Rosemère, Quebec, Canada
Corporate Director
Director since November 2008

Roseann Runte ²

Ottawa, Ontario, Canada
President and Vice-Chancellor,
Carleton University
Director since April 2001

Marc P. Tellier ¹

Montreal, Quebec, Canada
President and Chief Executive Officer,
Yellow Media Inc.
Director since March 2005

Louis Vachon

Beaconsfield, Quebec, Canada
President and Chief Executive Officer,
National Bank of Canada
Director since August 2006

- ¹ Human Resources Committee
- ² Conduct Review and Corporate Governance Committee
- ³ Audit and Risk Management Committee
- ⁴ Chairman of the Board of Directors
- (c) Committee Chairman

GOVERNANCE ARCHITECTURE

The main role of the Board of Directors (the Board) is to oversee the management of the Bank, safeguard its assets, and ensure its viability, profitability and development. The Board carries out this role through a governance architecture that includes a strict set of structures, policies and processes that meets all of the legislative and regulatory requirements governing the Bank. The majority of Board members, including its Chairman, are independent under Canadian Securities Administrators criteria.

As part of its responsibilities, the Board reviews and approves the Bank's strategic plan. It examines and approves the Bank's overall risk philosophy and risk appetite, identifies and assesses the main risks facing the Bank, and examines and approves the ways of controlling these risks to ensure effective management. It oversees the development and implementation of policies on the communication and disclosure of information to shareholders, investors

and the general public. The Board also evaluates management's performance and approves the Bank's total compensation programs and policies, including those of senior management.

The Board is assisted by three committees made up entirely of independent members: the Audit and Risk Management Committee, the Conduct Review and Corporate Governance Committee, and the Human Resources Committee.

Additional information on the Bank's governance architecture can be found in the Management Proxy Circular for the 2011 Annual Meeting of Holders of Common Shares, which will soon be available on the Bank's website at www.nbc.ca and on SEDAR's website at www.sedar.com. The complete mandates of the Board and its committees are available at www.nbc.ca.



Board committee	Key responsibilities
Audit and Risk Management Committee	<ul style="list-style-type: none">Examines the Bank's financial statements, reports and other significant financial communications and recommends their approval by the Board; ensures that adequate procedures are in place to oversee financial reporting to the public.Examines audit processes and management information systems.Reviews, evaluates and approves appropriate internal control policies.Oversees the external audit process.Oversees the work of the Internal Audit and Corporate Compliance departments.Examines statements, measures and overall targets related to the Bank's risk appetite and recommends their approval by the Board; oversees control methods to ensure their management.Oversees capital management, capital adequacy assessments, and stress testing.
Conduct Review and Corporate Governance Committee	<ul style="list-style-type: none">In charge of implementing governance rules, procedures and policies.Oversees the management and monitoring of related party transactions.Ensures adherence to standards of business conduct and ethical behaviour governing the Bank's directors, officers and employees.Assesses the performance and effectiveness of the Board and its members.
Human Resources Committee	<ul style="list-style-type: none">Examines and approves the Bank's total compensation policies and programs, taking into consideration the risk management framework applicable at the time of development, review and implementation, and recommends their approval by the Board.Sets objectives and key performance indicators for the President and Chief Executive Officer, whose performance and achievements are evaluated, and recommends their annual approval by the Board.Recommends Board approval for the compensation of the President and Chief Executive Officer and the members of the Office of the President.Oversees the management succession plan.

CORPORATE SOCIAL RESPONSIBILITY

National Bank Financial Group plays an important role in the economies of Quebec and Canada. Consequently, the Bank aims to have a positive influence on the communities in which it operates and to use its financial service offering as a lever for economic and social development.

This intent is reflected in rigorous corporate social responsibility principles and a series of proactive measures that have positive impacts on clients, employees, the economy, governance management, the environment and the community as a whole.

The Bank has committed to its clients to give them access to the best advice and the best financial solutions, regardless of their point of entry. This commitment has continued to materialize with the changeover to the *One client, one bank* initiative, which continued throughout the year. It was also manifested in the launch of one of the most important private-sector financial literacy initiatives carried out in 2010, the interactive portal *ClearFacts.ca*. *ClearFacts.ca* is designed as an Internet microsite that constitutes a hub of information, tools and valuable advice intended to develop the general public's—and particularly families'—skills and knowledge in the area of personal finance.

The Bank sees its employees as among its greatest assets. It attaches great importance to listening to their needs and offering them a stimulating environment in which they can fully realize their potential. In the Bank's view, this is the best way of building a team that is solid, competent and deeply committed to the causes it holds dear.

As an employer and service provider, to name but two of its roles, National Bank Financial Group makes a major contribution to economic activity. During fiscal 2010, the Bank authorized more than \$43 billion in loan financing to Canadian companies; as an employer, it paid more than \$1.6 billion in salaries and staff benefits.

National Bank Financial Group has based its governance model on strong values and some of the most rigorous ethics and professional conduct standards in the Canadian banking industry. It considers sound governance, combined with open and harmonious relationships with all stakeholders, to be essential to effective operations.

Environmental protection

With respect to the environment, the Bank is actively working to develop tools that will help it to improve its performance. As well, it uses all the means at its disposal to encourage clients, employees and suppliers to adopt more ecologically sound behaviours.

For example, the Bank uses its intranet to better inform employees about environmental issues, promote its own green success stories and generate as much inspiration as possible.

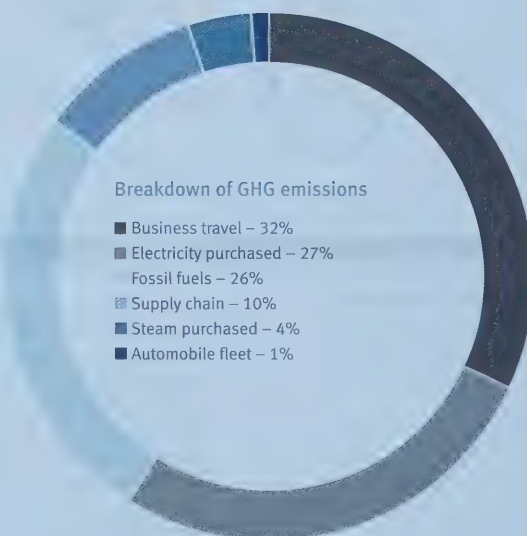
For several years, the Bank has been measuring its direct and indirect greenhouse gas (GHG) emissions. During fiscal 2009, GHG emissions resulting from the Bank's activities amounted to 13,833 tonnes of CO₂ equivalents.

The accuracy of the data used to measure the Bank's emissions has improved considerably. Over the last year, the inventory of activities measured, including business travel, rose from 85% to 96%.

Since 2007, National Bank Financial Group has been one of the companies included in the Dow Jones Sustainability North America Index and has participated in the Carbon Disclosure Project. This year, it was awarded a certificate attesting to its listing in the Canadian Carbon Disclosure Leadership Index, an honour roll of the top Canadian companies in terms of their understanding and management of the risks associated with climate change.

GHG emissions by category for 2009

Emission category	Emissions (tons of CO ₂ equivalents / year) CDP8
Direct emissions	3,750
Fossil fuels	3,630
Automobile fleet	120
Indirect emissions	4,302
Electricity purchased	3,802
Steam purchased	500
Other indirect emissions	5,781
Supply chain	1,325
Business travel	4,456
Grand total	13,833



COMMITMENT TO THE COMMUNITY



Many factors contribute to the Bank's achievement of its goals, including a well-defined donation and sponsorship program, successful fundraising efforts, and teams of current and retired employee volunteers who are determined to make a difference.

Its commitment to the community took various forms in the last year. Here are a few examples.

Our Hearts Are With Haïti campaign

In January 2010, the Bank rapidly implemented a series of measures to help victims of the earthquake in Haiti. The Our Hearts Are With Haiti campaign proved to be a huge success thanks to the generosity of National Bank Financial Group and its employees and clients. About \$1.3 million was raised in just a few weeks. All amounts raised were donated to the Canadian Red Cross.

Breakfast Clubs

National Bank Financial Group has been associated with the *Club des petits déjeuners du Québec* and the Breakfast Clubs of Canada for six years. In 2010, a major fundraising event was organized in the branches involving the sale of boxes of cookies, the recipe having been developed by a master chef and endorsed by a well-known dietician. When the Bank's corporate donations are combined with the amounts raised in its branch network, more than \$2 million has been paid to the organization since 2005.

Rogers Cup

In 2010, the Bank renewed its commitment to tennis by becoming title sponsor of the Toronto Rogers Cup, as well as extending its sponsorship of the Montreal tournament until 2013. The Bank is therefore associated with two of the flagship events in Canadian tennis and continues to support tournaments at various levels, thereby contributing to the development of the sport nationwide.

Our Hearts Are With You volunteer program

Through its Our Hearts Are With You program, launched six years ago, National Bank Financial Group recognizes and encourages volunteerism by current and retired employees. A financial contribution is made on behalf of employees who are eligible for the program to organizations where the employees volunteer. Moreover, every year, employees who have exhibited outstanding volunteerism are awarded special distinctions. The highest honour granted under the program is the André-Bérard Award.

In 2010, this prestigious award was presented to Yannick Munger, advisor at the Organizational Performance Centre in Montreal. Every summer, Mr. Munger spends a week as a counsellor at the Leucan Summer Camp. He was also instrumental in founding the Canadian Association of Pediatric Oncology Camps, an organization that ensures that high quality standards are defined and maintained for camps hosting children with cancer.

Two special mentions were also presented under this program. The first went to Catherine Coates, a personal finance advisor at the Orillia, Ontario, branch. Ms. Coates is an avid knitter and seamstress, who has developed a network producing and distributing blankets for less fortunate people in the region, which is affiliated with Mental Health Services at the Orillia Soldiers Memorial Hospital.

The second mention went to Maurice Dupont, a National Bank Financial retiree in Laval and co-founder of *La Fondation Gemini*, an organization that helps mothers-to-be and children from underprivileged families in the area.

National Bank Financial Group is delighted that its current and retired employees are committed and determined to using the tools available to them to launch community-minded initiatives.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis, December 8, 2010

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NOTES TO READERS

Compliance with Canadian Securities Administrators standards

This Management's Discussion and Analysis (MD&A) was prepared in accordance with the requirements set out in *Multilateral Instrument 51-102 Continuous Disclosure Obligations* of the Canadian Securities Administrators (CSA).

Caution regarding forward-looking statements

From time to time, National Bank of Canada (the Bank) makes written and oral forward-looking statements, such as those contained in the *Major Economic Trends* and the *Outlook for National Bank* sections in this Annual Report, in other filings with Canadian securities regulators, and in other communications, for the purpose of describing the economic environment in which the Bank will operate during fiscal 2011 and the objectives it has set for itself for that period. These forward-looking statements are made pursuant to the "safe harbour" provisions of Canadian and U.S. securities legislation. They include, among others, statements with respect to the economy—particularly the Canadian and U.S. economies—market changes, observations regarding the Bank's objectives and its strategies for achieving them, Bank projected financial returns and certain risks faced by the Bank. These forward-looking statements are typically identified by future or conditional verbs or words such as "outlook," "believe," "anticipate," "estimate," "project," "expect," "intend," "plan," and terms and expressions of similar import.

By their very nature, such forward-looking statements require assumptions to be made and involve inherent risks and uncertainties, both general and specific. Assumptions about the performance of the Canadian and U.S. economies in 2011 and how that will affect the Bank's business are among the main factors considered in setting the Bank's strategic priorities and objectives and in determining its financial targets, including provisions for credit losses. In determining its expectations for economic growth, both broadly and in the financial services sector in particular, the Bank primarily considers historical economic data provided by the Canadian and U.S. governments and their agencies. Tax laws in the countries in which the Bank operates, primarily Canada and the United States, are major factors it considers when establishing its effective tax rate. There is a strong possibility that express or implied projections contained in such statements will not materialize or will not be accurate. The Bank recommends that readers not place undue reliance on these statements, as a number of factors, many of which are beyond the Bank's control, could cause actual future results, conditions, actions or events to differ materially from the targets, expectations, estimates or intentions expressed in the forward-looking statements. These factors include the management of credit, market and liquidity risks; the strength of the Canadian and U.S. economies and the economies of other countries in which the Bank conducts business; the impact of the movement of the Canadian dollar relative to other currencies, particularly the U.S. dollar; the effects of changes in monetary policy, including changes in interest rate policies of the Bank of Canada and the U.S. Federal Reserve; the effects of competition in the markets in which the Bank operates; the impact of changes in the laws and regulations regulating financial services and enforcement thereof (including banking, insurance and securities); judicial proceedings, regulatory proceedings or claims, class actions or other recourses of various nature; the situation with respect to the restructured notes of the master asset vehicle (MAV) conduits, in particular the realizable value of underlying assets; the Bank's ability to obtain accurate and complete information from or on behalf of its

clients or counterparties; the Bank's ability to successfully realign its organization, resources and processes; its ability to complete strategic acquisitions and integrate them successfully; changes in the accounting policies and methods the Bank uses to report its financial condition, including uncertainties associated with critical accounting assumptions and estimates; the Bank's ability to recruit and retain key officers; operational risks, including risks related to the Bank's reliance on third parties to ensure access to the infrastructure essential to the Bank's business as well as other factors that may affect future results, including changes in trade policies; timely development of new products and services; changes in estimates relating to reserves; changes in tax laws; technological changes; unexpected changes in consumer spending and saving habits; natural disasters; the possible impact on the business from public health emergencies, conflicts, other international events and developments, including those relating to the war on terrorism; and the Bank's success in anticipating and managing the foregoing risks. A substantial amount of the Bank's business involves making loans or otherwise committing resources to specific companies, industries or countries. Unforeseen events affecting such borrowers, industries or countries could have a material adverse effect on the Bank's financial results, businesses, financial condition, or liquidity.

The foregoing list of risk factors is not exhaustive. Additional information about these factors can be found under *Risk Management* and *Factors That Could Affect Future Results* in this Annual Report. Investors and others who base themselves on the Bank's forward-looking statements should carefully consider the above factors as well as the uncertainties they represent and the risk they entail. The Bank also cautions readers not to place undue reliance on these forward-looking statements. Except as required by law, the Bank does not undertake to update any forward-looking statements, whether written or oral, that may be made from time to time, by it or on its behalf.

The forward-looking information contained in this document is presented for the purpose of interpreting the information contained herein and may not be appropriate for other purposes.

Financial reporting method

The consolidated financial statements of the Bank are prepared in accordance with Canadian generally accepted accounting principles (GAAP). Unless otherwise stated, all amounts presented in the Management's Discussion and Analysis are expressed in Canadian dollars.

The Bank uses certain measurements that do not comply with GAAP to assess results. Securities regulators require companies to caution readers that net earnings and any other measurements adjusted using non-GAAP criteria have no standard meaning under GAAP and cannot be easily compared with similar measurements used by other companies. Like many other institutions, the Bank uses the taxable equivalent basis to calculate net interest income, other income and income taxes. This calculation method consists of grossing up certain tax-exempt income (particularly dividends) by the income tax that would have otherwise been payable. An equivalent amount is added to income taxes. This adjustment is necessary in order to perform a uniform comparison of the return on different assets regardless of their tax treatment. Moreover, the Bank has adjusted certain revenues and expenses related to restructured notes of the MAV conduits as well as certain one-time items to make the data from fiscal 2010 and 2009 comparable. These adjustments are presented in the table on the following page.

Reconciliation of measures not compliant with GAAP

Reconciliation of results published with results presented in the Management's Discussion and Analysis

	Segment	2010	2009
Net interest income		1,912	1,966
Taxable equivalent ⁽¹⁾		206	129
Interest received or receivable on restructured notes of the MAV conduits ⁽²⁾	Other	–	(56)
Financing cost of restructured notes of the MAV conduits ⁽²⁾	Other	11	16
Net interest income on a taxable equivalent basis and excluding specified items		2,129	2,055
Other income		2,366	2,165
Taxable equivalent ⁽¹⁾		–	19
Loss on available-for-sale securities ⁽²⁾	Other	–	190
Loss on economic hedge transactions of restructured notes of the MAV conduits ⁽²⁾	Other	–	28
Other income on a taxable equivalent basis and excluding specified items		2,366	2,402
Total revenues on a taxable equivalent basis and excluding specified items		4,495	4,457
Operating expenses		2,811	2,662
Restructuring charge ⁽³⁾	Financial Markets	(22)	–
Impairment of an intangible asset ⁽⁴⁾	Wealth Management	(2)	–
Administrative penalty ⁽⁵⁾	Other	(75)	–
Professional fees related to restructured notes of the MAV conduits ⁽²⁾	Other	–	1
Operating expenses excluding specified items		2,712	2,663
Contribution on a taxable equivalent basis and excluding specified items		1,783	1,794
Provision for credit losses		144	305
Provision for credit losses related to holding restructured notes of the MAV conduits ⁽²⁾	Other	–	(126)
Provision for credit losses excluding specified items		144	179
Income before income taxes and non-controlling interests on a taxable equivalent basis and excluding specified items		1,639	1,615
Income taxes		221	252
Taxable equivalent ⁽¹⁾		206	148
Reversals of provisions for income tax contingencies ⁽⁶⁾	Other	50	–
Income taxes related to the restructuring charge ⁽³⁾	Financial Markets	7	–
Income taxes related to the holding of restructured notes of the MAV conduits ⁽²⁾	Other	3	96
Income taxes on a taxable equivalent basis and excluding specified items		487	496
Non-controlling interests		68	58
Net income excluding specified items		1,084	1,061
Specified items, net of income taxes		(50)	(207)
Net income		1,034	854

(1) The Bank uses the taxable equivalent basis to calculate net interest income, other income and income taxes. This calculation method consists of grossing up certain tax-exempt income (particularly dividends) by the income tax that would have otherwise been payable. An equivalent amount is added to income taxes. This adjustment is necessary in order to perform a uniform comparison of the return on different assets regardless of their tax treatment.

(2) The restructured notes of the master asset vehicle (MAV) conduits replaced asset-backed commercial paper (ABCP) under the restructuring plan for these instruments. During the year ended October 31, 2010, the Bank recognized \$11 million in financing costs (\$16 million in 2009) related to the holding of restructured notes of the MAV conduits. During the year ended October 31, 2009, the Bank had also recognized the following items related to the holding of restructured notes of the MAV conduits: \$56 million in interest received or receivable, a \$190 million loss on available-for-sale securities, a \$28 million loss on economic hedge transactions, a \$1 million recovery of professional fees, and a \$126 million provision for credit losses. Total income taxes for these items amounted to \$3 million for the year ended October 31, 2010 (\$96 million for the year ended October 31, 2009).

(3) During the year ended October 31, 2010, the Bank recorded a restructuring charge of \$22 million (\$15 million net of income tax). This charge consisted mainly of severance pay related to the restructuring of certain activities in the investment dealer subsidiary.

(4) During the year ended October 31, 2010, the Bank recognized a \$2 million impairment of an intangible asset related to the activities of Altamira.

(5) During the year ended October 31, 2010, a \$75 million administrative penalty was recognized as part of a settlement of an ABCP industry-wide agreement.

(6) During the year ended October 31, 2010, income tax provisions totalling \$50 million were reversed as a result of a revaluation of income tax contingencies.

Factors that could affect future results

Several risk factors can affect the Bank's future results. As noted in the *Caution Regarding Forward-Looking Statements* section of this Annual Report, all forward-looking statements, by their nature, are subject to inherent risks and uncertainties, general and specific, which may cause the Bank's actual results to differ significantly from those set out in the forward-looking statements. Some of these factors are discussed below. Other factors are identified in the *Caution Regarding Forward-Looking Statements* section, and certain factors such as credit risk, market risk, liquidity risk and operational risk as well as other risk factors are discussed in the *Risk Management* section that begins on page 61 of this Annual Report.

Key factors

General economic and business conditions in regions where the Bank operates

Although the Bank operates primarily in Canada, it also has business operations in the United States and other countries. The economic and business conditions in these geographic regions can therefore affect the Bank's revenues. Such conditions include short and long-term interest rates, inflation, fluctuations in debt securities markets and financial markets, exchange rates, the volatility of the subprime mortgage market in the United States and related markets, the tightening of liquidity in various financial markets, the strength of the economy, and the level of the Bank's business activity. All of these factors affect the business and economic conditions in a given geographic region and, consequently, affect the Bank's level of business activity and resulting earnings in that region.

Currency rates

Currency rate movements in Canada, the United States and other countries in which the Bank does business can significantly impact the Bank's financial position and future earnings as a result of foreign currency translation adjustments. A rising Canadian dollar may also adversely affect the earnings of the Bank's SME and corporate clients.

Monetary policies

The monetary policies of the Bank of Canada and the U.S. Federal Reserve as well as other interventionist measures in capital markets have repercussions on the Bank's revenues. Changes in the money supply and the general level of interest rates can impact the Bank's profitability. The Bank has no control over changes in monetary policies or capital market conditions.

Competition

The extent of competition in the markets where the Bank operates has an impact on its performance. Retaining clients hinges on several factors, including the price of products and services, quality of service, and changes to the products and services offered.

Legislative and regulatory amendments and changes to guidelines

Various laws, regulations and other guidelines have been introduced by governments and regulatory bodies to protect the interests of the general public as well as the Bank's clients, employees and shareholders. Changes to these laws, regulations and other guidelines, including those that affect how they are interpreted and applied, could have an impact on the Bank. In particular, they could limit its product and service offering or enhance its competitors' ability to rival the Bank's offering with their own. Also, in spite of the precautions the Bank takes to prevent such an eventuality, failure to comply with laws, regulations and other guidelines could give rise to penalties and fines likely to have an adverse impact on its financial results and reputation.

Accuracy and completeness of information on clients and third parties

In decisions related to authorizing credit or other transactions with clients and third parties, the Bank may use information provided by them, in particular their financial statements and other financial information. The Bank may also refer to statements made by clients and third parties regarding the accuracy and completeness of this information and the auditors' reports on their financial statements. In the event these financial statements are misleading or do not present fairly, in all material respects, their financial position or operating results, the Bank's revenues could be adversely impacted.

Accounting policies and methods used by the Bank

The accounting policies and methods used by the Bank determine how the Bank reports its financial position and operating results and may require management to make estimates or rely on assumptions about matters that are inherently uncertain. Any changes to these estimates and assumptions may have a significant impact on the Bank's operating results and financial position. In addition, as of November 1, 2011, the Bank will be applying International Financial Reporting Standards (IFRS). Therefore, for the quarter ended January 31, 2012, the Bank will present consolidated financial statements in accordance with IFRS and will present comparative IFRS figures for fiscal 2011, including an opening consolidated balance sheet as at November 1, 2010. Adopting the IFRS accounting framework will result in adjustments to the opening balance sheet and to retained earnings at the time of transition. The Bank has already identified significant differences between Canadian GAAP and IFRS, differences that will likely have a notable impact on the Bank's consolidated financial statements. For additional information, refer to the *Future Accounting Policy Changes* section on page 56.

New products and services to maintain or increase market share

The Bank's ability to maintain or increase market share depends, in part, on how it adapts products and services in response to changes in industry standards. There is increasing pressure on financial institutions to provide products and services at lower prices, which could reduce the Bank's net interest income and revenues from fee-based products and services. In addition, new technologies that may be implemented or modified to be better adapted to the Bank's products and services could involve substantial expenditure without any guarantee as to the successful deployment of the new products or services or as to the development of a client base for them.

Acquisitions

The Bank's ability to successfully complete an acquisition is often conditional on regulatory approval, and the Bank cannot be certain when or under what conditions, if any, approval will be granted. Acquisitions may affect future results depending on whether the Bank succeeds in integrating the acquired company. If the Bank or its subsidiary encounters difficulty in integrating the acquired business, maintaining the appropriate level of governance over the acquired business, or retaining key officers within the acquired business, these factors could prevent the Bank from realizing expected revenue growth, cost savings, market share gains and other projected benefits from the acquisition.

Ability to attract and retain key officers

The Bank's future performance depends largely on its ability to attract and retain key officers. There is intense competition for the best people in the financial services industry, and there is no assurance that the Bank, or any entity it acquires, will be able to continue to attract and retain key officers.

Commercial infrastructure and outsourcing agreements

Third parties provide the essential components of the Bank's commercial infrastructure, such as Internet connections and access to network and other communications services. The Bank is also party to two major outsourcing agreements, one for IT support and one for cash management and processing. Interruptions in these services can adversely affect the Bank's ability to provide products and services to its clients and conduct its business.

Other factors

Other factors that could affect the Bank's future results include amendments to tax legislation, unexpected changes in consumer spending and saving habits, technological advances, the ability to activate a business continuity plan within a reasonable time, the potential impact of international conflicts or natural catastrophes on the Bank's activities, and the Bank's ability to foresee and effectively manage the risks associated with these factors through rigorous risk management.

The Bank cautions readers that other factors in addition to those indicated above could have an impact on its future results. When relying on forward-looking statements to make decisions concerning the Bank, investors and other stakeholders should carefully consider these factors and all other uncertainties, potential events, and industry-related or Bank-specific factors that could negatively affect future results.

Additional disclosure

Additional information about National Bank of Canada, including the Annual Information Form, can be obtained from the Bank's website at www.nbc.ca and SEDAR's website at www.sedar.com.

FINANCIAL DISCLOSURE

Disclosure controls and procedures

Preparation of the Bank's financial information is supported by a set of disclosure controls and procedures implemented by the President and Chief Executive Officer (CEO) and by the Chief Financial Officer and Executive Vice-President of Finance, Risk and Treasury (CFO). In fiscal 2010, in accordance with *Multilateral Instrument 52-109, Certification of Disclosures in Issuers' Annual and Interim Filings* (NI 52-109), the design and operation of these controls and procedures underwent an evaluation to determine their effectiveness.

As at October 31, 2010, the Chief Executive Officer and the Chief Financial Officer have confirmed the effectiveness of the disclosure controls and procedures. These controls are designed to provide reasonable assurance that the information disclosed in the annual or interim filings or other reports filed or submitted under securities legislation is recorded, processed, summarized and reported within the time periods specified by that legislation. These controls and procedures are also designed to ensure that such information is accumulated and communicated to the Bank's management, including its signing officers, as appropriate, to allow timely decisions regarding disclosure.

This Annual Report was reviewed by the Annual and Quarterly Information Disclosure Committee, the Audit and Risk Management Committee, and the Board of Directors, which approved it prior to publication.

Internal controls over financial reporting

The internal controls over financial reporting (ICFR) are designed to provide reasonable assurance that the financial information presented is reliable and that the financial statements were prepared in accordance with Canadian generally accepted accounting principles (GAAP). Due to inherent limitations, ICFR may not prevent or detect all misstatements in a timely manner.

The CEO and the CFO oversaw the evaluation work performed on the design and operation of the Bank's ICFR in accordance with National Instrument 52-109. These controls were evaluated in accordance with the control framework of the Committee of Sponsoring Organizations of the Treadway Commission (COSO) for financial controls and in accordance with the control framework of the Control Objectives for Information and Related Technologies (COBIT) for general IT controls.

Based on the results of the evaluation, the CEO and CFO concluded, as at October 31, 2010, that there are no material weaknesses, that the ICFR are effective and provide reasonable assurance that the financial reporting is reliable, and that the Bank's consolidated financial statements were prepared in accordance with Canadian GAAP.

During fiscal 2010, in preparation for the conversion to IFRS and under the supervision of the CEO and CFO, the internal controls documentation team monitored the work performed by the specialized team dedicated to the IFRS conversion project and, in so doing, was able to ascertain the future adjustments to be made to the design and operation of ICFR. Adjustments to the design of the controls, and any new controls will be documented during fiscal 2011 in anticipation of the tests on the operation of these controls planned for 2012.

Changes to internal controls over financial reporting

The CEO and CFO also took further steps that enabled them to conclude that, during the year ended October 31, 2010, no changes were made to the ICFR that have materially affected, or are reasonably likely to materially affect, these ICFR.

Annual and Quarterly Information Disclosure Committee

The Annual and Quarterly Information Disclosure Committee assists the CEO and CFO by ensuring that disclosure controls and procedures and internal control procedures for financial reporting are implemented and operational. The Committee can therefore verify that the Bank is meeting its disclosure obligations under current regulations and that the CEO and CFO are producing the requisite certifications.

OVERVIEW

Consolidated results					
Year ended October 31 (taxable equivalent basis ⁽¹⁾) (millions of dollars)					
	2010	2009	2008	% change 2010-09	% change 2009-08
Excluding specified items⁽¹⁾					
Total revenues	4,495	4,457	3,953	1	13
Operating expenses	2,712	2,663	2,559	2	4
Provision for credit losses	144	179	117	(20)	53
Income before income taxes and non-controlling interests	1,639	1,615	1,277	1	26
Income taxes	487	496	475	(2)	4
Non-controlling interests	68	58	(145)	17	(140)
Net income excluding specified items	1,084	1,061	947	2	12
Specified items after taxes	(50)	(207)	(171)	(76)	21
Net income	1,034	854	776	21	10
Diluted earnings per share	\$5.94	\$4.94	\$4.67	20	6
Average assets	140,358	140,978	128,319	—	10
Risk-weighted assets ⁽²⁾	49,831	58,607	58,069	(15)	1
Average loans and acceptances	59,059	56,236	53,053	5	6
Average deposits	80,069	77,653	73,298	3	6
Net impaired loans ⁽³⁾	(267)	(233)	(162)	15	44
Return on common shareholders' equity (ROE)	17.0%	15.6%	16.4%		
Excluding specified items⁽¹⁾					
Diluted earnings per share	\$6.25	\$6.22	\$5.75	—	8
Return on common shareholders' equity (ROE)	17.7%	19.0%	19.7%		
Efficiency ratio ⁽⁴⁾	60.4%	59.7%	64.7%		

(1) See *Financial Reporting Method* on pages 18 and 19.

(2) In 2008, the Bank adopted the rules of the Basel II Accord, and as of November 1, 2009, it has been applying the Advanced Internal Rating-Based Approach for credit risk; prior to that date, it had been using the Standardized Approach.

(3) Net of general and specific allowances.

(4) Adjusted for gains or losses attributable to third parties.

The Bank recorded net income of \$1,034 million for fiscal 2010 compared to \$854 million for fiscal 2009. Diluted earnings per share stood at \$5.94 versus \$4.94 for fiscal 2009. ROE was 17.0% for fiscal 2010 versus 15.6% in 2009. However, excluding the specified items for 2010 and 2009, the Bank's net income rose 2% to total \$1,084 million, and diluted earnings per share stood at \$6.25 versus \$6.22. Similarly, ROE was 17.7%.

2010 financial indicators

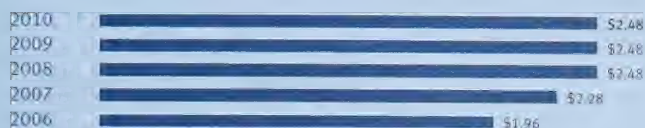
	Results	Results excluding specified items
Growth in diluted earnings per share	20%	—
Return on common shareholders' equity (ROE)	17.0%	17.7%
Tier 1 capital ratio	14.0%	14.0%
Dividend payout ratio ⁽¹⁾	41%	39%

(1) Last four quarters.

Dividends

In fiscal 2010, the Bank declared \$402 million in dividends to common shareholders, representing 39% of available net income, excluding specified items.

Annual dividend



High quality loans portfolio

The Bank also maintained sound credit quality. Overall, excluding specified items, the provision for credit losses in fiscal 2010 represented 0.24% of average loans and acceptances compared to 0.32% a year earlier. The provision for credit losses in fiscal 2010, excluding specified items, decreased \$35 million to total \$144 million at year-end. This decline was primarily due to recoveries of losses on commercial and corporate credit. In addition, the general allowance totalled \$429 million as at October 31, 2010, down \$27 million from October 31, 2009 as a portion of the allowance for credit facilities was applied to restructured notes of the MAV conduits taken back by the Bank.

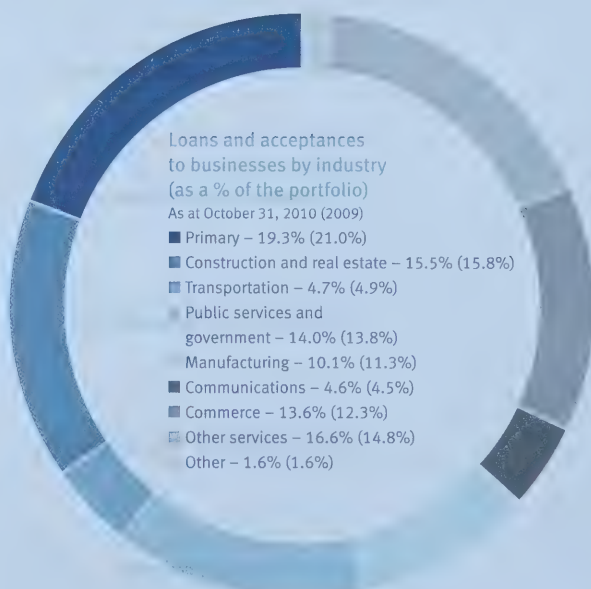
Risk profile

Credit losses and impaired loans
(millions of dollars)

	2010	2009
Provision for credit losses ⁽¹⁾	144	179
Provision for credit losses as a % of average loans and acceptances ⁽¹⁾	0.24%	0.32%
Net impaired loans	162	223
Gross impaired loans as a % of tangible equity	6.7%	8.3%
Specific allowances as a % of impaired loans	56.1%	45.2%
General allowance	429	456
Impaired loans, net of general and specific allowances	(267)	(233)

(1) Excluding specified items. See *Financial Reporting Method* on pages 18 and 19.

Overall composition of the loan and acceptance portfolio



PRUDENT CAPITAL MANAGEMENT

Capital management is an important component of financial management at the Bank. It takes into account regulatory obligations, economic and market conditions, corporate objectives and creation of shareholder value. Since November 1, 2009, the Bank has been applying the Advanced Internal Rating-Based Approach (AIRB Approach) for credit risk instead of the Standardized Approach used previously. For operational risk, the Bank is using the Standardized Approach and, for market risk, it continues to use the models and the Standardized Approach set out in the Basel II Accord.

In 2010, the Bank maintained its prudent capital management approach in order to protect itself against deteriorating markets and ensure sound business growth.

A solid financial foundation

According to the rules of the Bank for International Settlements (BIS) – Basel II, the Tier 1 capital ratio and the total capital ratio stood at 14.0% and 17.5%, respectively, as at October 31, 2010; as at October 31, 2009, these same ratios were 10.7% and 14.3%, respectively. The increase in the capital ratios was largely due to the Bank's adoption of the AIRB Approach and to higher retained earnings. The increase in the total capital ratio was partially mitigated, however, by a lower eligible general allowance in the ratio calculation, as a result of the adoption of the AIRB Approach for credit risk under the Basel II Accord.

A bank's capital covers the risks associated with its various activities, such as credit risk, unfavourable changes in financial markets, or negative operating events.

Change in the Tier I and total capital ratios
(under Basel II)



Positive contribution from the segments

In 2010, shareholder value added, i.e., available net income less a cost of capital of 11%, was \$342 million. Altogether, allocated economic capital increased 2%, demonstrating that growth in activities did not significantly increase risk.

Allocation of economic capital

Year ended October 31

(millions of dollars)

	2010	2009	% change
Average capital	5,718	5,104	12
Available net income	971	795	22
Cost of capital	629	561	12
Shareholder value added	342	234	46
Allocated economic capital	3,787	3,726	2
Unallocated economic capital	1,931	1,378	40
Capital allocated by segment			
Personal and Commercial	1,298	1,412	(8)
Wealth Management	435	385	13
Financial Markets	1,852	1,750	6
Other	202	179	13
Capital allocated by risk category			
Credit risk	1,682	1,771	(5)
Market risk	907	754	20
Operational risk	495	522	(5)
Business risk	703	679	4

MAJOR ECONOMIC TRENDS

Global economy

The world recovery is proceeding at an uneven pace. Emerging economies are in the driver's seat. Though growth in the advanced economies is more modest, the international trade flows that were severely impaired by the financial crisis have rebounded strongly. Asia has been among the main beneficiaries, regaining the ground lost when its exports slumped during the recession. Robust industrial production and a rising consumer base in China and India have supported commodity prices, to the benefit of commodity-exporting countries.

Though a number of countries are likely to take steps to normalize monetary policy in the coming year, financial conditions are unlikely to turn restrictive. The central banks will have to take into account the fiscal adjustments that governments of the mature economies are about to implement in order to put debt-to-GDP ratios on more sustainable paths. The need to do so was thrown into relief by concerns over the European sovereign debt.

Despite growth of only about 2% in the advanced economies, global GDP is likely to expand about 3.5% in 2011, down from 4.5% in 2010. Growth will be buoyed by the emerging economies, whose combined GDP is getting close to that of the OECD countries. Protectionism and competitive currency devaluation are the key risks to this outlook.

United States

The U.S. economy is slowly recovering from the worst recession in 70 years. Business investment was a driving force of the recovery early on. More recently, however, its contribution to GDP growth has appeared to be fading.

Absent a policy response, this development may suggest a less robust pace of expansion going forward, since households are still working to deleverage their balance sheets and consumer spending remains constrained by modest income growth and high unemployment. The U.S. labour market lost 8.4 million jobs from the pre-recession peak to the employment bottom in December 2009, pushing the unemployment rate to 10.1%. Since then, the economy has grown but job creation has been disappointing.

The U.S. Federal Reserve, facing substantial resource slack, the prospect of slow growth and inflation below its long-term objective, announced that it would purchase \$600 billion in Treasury securities by the end of the second quarter of 2011 to provide further liquidity to the U.S. economy. This second round of quantitative easing by the Fed is all the more welcome given the unlikelihood of further fiscal stimulus from Washington. By fostering an environment of low interest rates, the current monetary policy stance should go far toward keeping the U.S. economy growing at somewhat more than 2% in 2011.

Canada

Canadian real GDP passed the pre-recession peak in June 2010. Employment did the same last August. Canada has thus recovered from the recession, which is more than can be said of the U.S. and a number of other industrialized countries. The contraction was felt less in Quebec than in the rest of Canada, and Quebec's recovery was generally faster. In Canada as elsewhere, governments and the central bank took fiscal and monetary action to stimulate domestic demand. These measures bore more fruit in Canada because of the soundness of its financial system. For 2010 as a whole, the Canadian economy is headed for growth of 3.1%, the best performance in six years.

Not all sectors are unscathed. Canadian manufacturers, who export about half their production to the U.S., have far to go to regain the ground lost in the recession. In other sectors, notably housing, one effect of low interest rates was to front-load spending. In addition, governments intent on bringing budgets back into balance in the medium term will wind down the stimulus they deployed to fight the recession. These factors combined with the sluggish recovery in manufacturing will weigh on employment growth. This development in the labour market will counsel prudence to households, whose indebtedness leaves them vulnerable to a rise in interest rates. However, continued strong demand for commodities from emerging countries will offset some of this drag so as to keep the Canadian economy growing at about 2.0% (2.2% for Quebec) in 2011.

The appreciation of the Canadian dollar, whose average exchange value could somewhat exceed parity with the U.S. dollar in 2011, is not all bad news for Canadian export producers. A strong currency reduces the cost of acquiring imported machinery and equipment to increase productivity, an area in which Canadian companies have lagged in recent years. Also, the generally strong balance sheets of Canadian producers give them the means to improve their competitive positions.

OUTLOOK FOR NATIONAL BANK

Medium-term objectives

To reflect its strategic priorities and changes to the rules of the Basel Accord, the Bank has modified certain medium-term objectives.

Medium-term objectives

Growth in diluted earnings per share ⁽¹⁾	5% – 10%
Return on common shareholders' equity	15% – 18%
Core Tier 1 under Basel III	More than 7.0%
Dividend payout ratio	40% – 50%

(1) Excluding specified items.

Strategic priorities

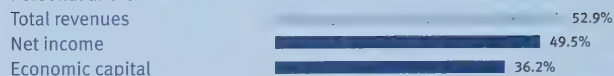
National Bank's objective is to consistently deliver returns to shareholders that match or exceed those of its Canadian peers. To achieve this goal, the Bank is targeting 5-10% annual net income growth and continuous productivity improvement while maintaining sound risk management practices.

Increased market penetration in the Quebec market, which accounts for approximately two-thirds of total revenues, offers the strongest revenue growth potential for the foreseeable future. The Bank's long-term objective is to increase the revenue contribution of its Personal and Commercial and Wealth Management segments in its business mix. Potential revenue growth also lies in geographic diversification by leveraging the Bank's existing footprint and entering selected new niches across Canada. As a super regional institution with a healthy balance sheet, the Bank is also well-positioned to complement organic growth with acquisitions in its three business segments. These revenue growth opportunities are reflected in the Bank's allocation of capital, human resources and effort.

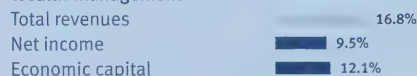
Business mix⁽¹⁾

Year ended October 31, 2010

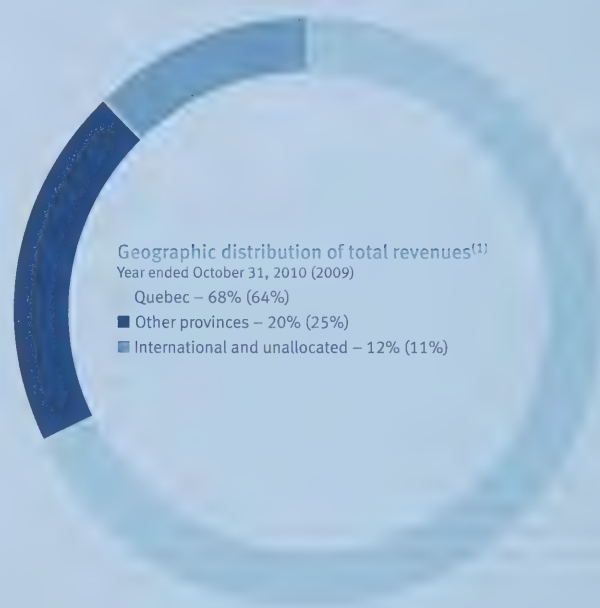
Personal and Commercial



Wealth Management



Financial Markets



(1) Excluding specified items.

One client, one bank

The central component of the Bank's strategy is its *One client, one bank* initiative. The overarching purpose of this initiative is to transform National Bank Financial Group into a leader in client experience, with the ability to provide best-in-class financial advice, solutions, and service to its clients, regardless of their point of entry into the Bank.

The Bank's strategy, adopted at the end of 2008, has a long-term focus and is driven by four priorities:

- Align distribution with client needs across the Bank.
- Simplify processes and deploy a new sales and service platform.
- Improve the efficiency of corporate functions.
- Instil a culture of collaboration, accountability and performance.

The past two years have witnessed notable progress and positive results, validating the Bank's strategic direction. Important milestones have been achieved in the execution of all four priorities.

Distribution

Phase I of the strategy, the alignment of distribution with client needs across the Bank, has been completed.

- The Bank's organizational structure is now client-centric, and all sales and service activities are designed according to client needs based on the Bank's market segmentation.
- Sales and service capacity has been augmented with the addition of over 300 new client-facing positions in Personal and Commercial Banking.
- Compensation is being used to encourage teamwork and greater collaboration across organizational boundaries, and new guidelines are in place to promote referrals.
- Thousands of branch employees and managers have participated in training to understand their roles and responsibilities under the Bank's client-centric distribution model.

Processes and systems

Phase II of the strategy—the simplification and streamlining of business processes and the deployment of a new sales and service platform—is now well underway. The Bank has selected an advanced SAP Customer Relationship Management system and is working with Accenture and CGI on the integration.

During this phase, all retail banking business processes and procedures will be reviewed end-to-end and simplified to shorten decision time while respecting the Bank's risk management principles.

Important business advantages and efficiency gains will be realized as each new business process is implemented.

- Administrative workload will diminish and front-line staff will have more time for building client relationships.
- The new sales and service platform will be a valuable tool by providing a comprehensive view of each client's relationship with the Bank and its full suite of financial solutions.
- Cost savings will be generated through higher productivity.

Corporate units

The Bank has reviewed its corporate functions to improve synergy, coordination and efficiency. Substantial recurring savings have already been realized, mainly in procurement and information technology (IT). All corporate functions have been aligned to contribute directly to the business objectives of the Bank's segments.

Responsibility for IT was centralized to promote standardization and build economies of scale and efficiencies. With this new structure, IT spending is moving from a tactical to strategic vision, making this critical function a key enabler of the Bank's long-term strategy.

Culture

Delivering a satisfying client experience is at the core of the *One client, one bank* initiative, and the Bank's success lies ultimately with its more than 18,000 employees. Effective execution requires a strong culture of collaboration, accountability, and performance at all levels of the organization, and the Bank is strengthening its management practices to promote these values. Early successes are helping to build trust and confidence among the Bank's divisions and business units, paving the way to greater teamwork, the sharing of best practices, and a seamless organization that places client satisfaction at the top of its priorities.

BUSINESS SEGMENT ANALYSIS

PERSONAL AND COMMERCIAL

OVERVIEW

The Personal and Commercial Banking segment offers a full range of financial solutions, products and services to clients across Canada through its branches and business centres as well as through remote banking and a network of partners coast to coast.

Personal Banking serves the financial needs of more than 2.3 million retail clients across Canada—from everyday transaction solutions to mortgage and consumer loans, credit cards and a range of savings options and investment solutions to suit every need. Through specialized subsidiaries, the Bank offers comprehensive insurance solutions, including home and automobile coverage, life and health insurance, as well as creditor protection on loans. The Bank's products and services are conveniently accessible through 442 branches, 869 banking machines, and telephone and Internet banking.

Commercial Banking serves the financial needs of approximately 130,000 small and medium-sized enterprises (SME) and commercial clients across Canada. The Bank offers a complete range of services, including credit, deposit and investment solutions, international trade services such as trade finance and foreign exchange, payroll, cash management, insurance, electronic transactions and complementary services. While providing financial and transactional solutions for businesses, the Bank is proactive in meeting the personal financial needs of entrepreneurs and business owners and managers.

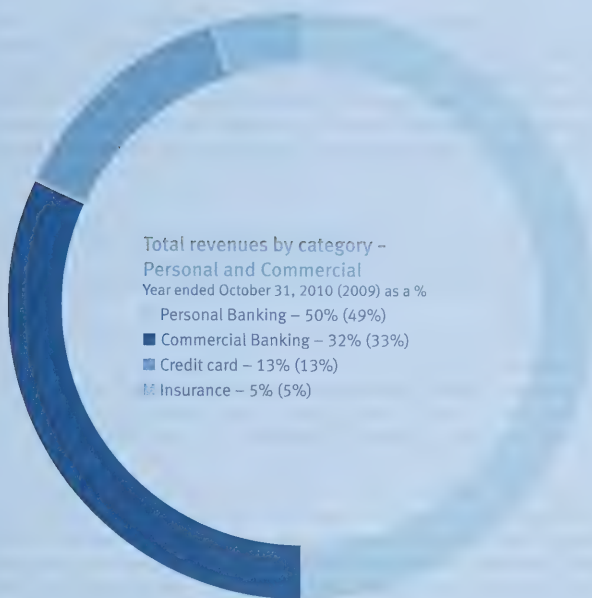
Segment Results – Personal and Commercial

Year ended October 31
(taxable equivalent basis⁽¹⁾)
(millions of dollars)

	2010	2009	2008	% change 2010-09	% change 2009-08
Net interest income	1,511	1,407	1,390	7	1
Other income	915	880	842	4	5
Total revenues	2,426	2,287	2,232	6	2
Operating expenses	1,383	1,356	1,302	2	4
Contribution	1,043	931	930	12	–
Provision for credit losses	207	214	179	(3)	20
Income before income taxes	836	717	751	17	(5)
Income taxes	249	235	247	6	(5)
Net income	587	482	504	22	(4)
Net interest margin	2.49%	2.51%	2.66%		
Average assets	60,671	56,070	52,306	8	7
Risk-weighted assets ⁽²⁾	27,387	28,189	29,133	(3)	(3)
Average deposits	34,446	33,565	31,779	3	6
Average loans and acceptances	60,300	55,693	51,904	8	7
Net impaired loans	147	151	134	(3)	13
Net impaired loans as a % of loans and acceptances	0.2%	0.3%	0.3%		
Efficiency ratio	57.0%	59.3%	58.3%		

(1) See *Financial Reporting Method* on pages 18 and 19.

(2) In 2008, the Bank adopted the rules of the Basel II Accord and, since November 1, 2009, it has been applying the Advanced Internal Rating-Based Approach for credit risk, whereas prior to that date, it had been using the Standardized Approach.



Financial results

Net income for the Personal and Commercial segment totalled \$587 million in 2010, up 22% from \$482 million in 2009. At \$2,426 million, total revenues increased by \$139 million or 6% from \$2,287 million in 2009. Revenue growth was driven mainly by higher loan volumes, which more than offset tighter spreads on deposits. Net interest margin narrowed to 2.49% in 2010 compared to 2.51% in 2009 and 2.66% in 2008.

Operating expenses were up 2% in 2010, mostly a reflection of higher payroll mitigated by the major projects that were completed in 2009, particularly the replacement of all the banking machines and the introduction of smart cards. The efficiency ratio improved to 57.0% for fiscal 2010 compared to 59.3% in 2009 and 58.3% in 2008.

Quarterly results
 (taxable equivalent basis⁽¹⁾)
 (millions of dollars)

Q4 2010

Total revenues	621
Operating expenses	365
Net income	145

Q3 2010

Total revenues	621
Operating expenses	346
Net income	162

Q2 2010

Total revenues	591
Operating expenses	335
Net income	141

Q1 2010

Total revenues	593
Operating expenses	337
Net income	139

(1) See *Financial Reporting Method* on pages 18 and 19.

At \$207 million, the provision for credit losses was down \$7 million from \$214 million in 2009. Losses on credit card receivables and personal loans remained stable compared to 2009. Most of the decrease was attributable to credit losses in Commercial Banking, a sign of improvement given the current economic situation and confirms the good quality of the loan portfolio.

Personal Banking

In 2010, Personal Banking revenues increased by 7% to total \$1,641 million compared to \$1,539 million in 2009, driven mainly by loan volume growth. Credit volumes rose 9% compared to 2009, mainly due to growth in secured credit, particularly mortgages and home equity lines of credit. The volume of investment loans increased 1% compared to 2009. Despite a slight decline in personal deposits outstanding, revenues from savings and investing activities as well as from transaction activities remained stable, mainly due to a narrower net interest margin on deposits, offset by volume growth.

The Bank continued to expand its insurance activities, achieving 5% revenue growth in 2010 through an increase in clients, a slight decline in gross premiums, and a lower loss ratio. MasterCard revenues increased 7% as a result of higher transaction volume.

Commercial Banking

In 2010, Commercial Banking revenues totalled \$785 million, up 5% from \$748 million in 2009. The increase came mainly from higher loan volumes, higher lending fees and acceptances as well as from revenues from deposit activities, attributable to a slight increase in spreads on deposits. Revenues from other activities, which include international services such as foreign exchange, decreased by 10%.

Strategies and achievements

With the implementation of Phase I of its *One client, one bank* approach, the Bank is optimizing and leveraging its new distribution model in Quebec to deepen client relationships and generate higher revenues. It is also working to build a proactive sales and service culture focused on client needs. Phase II of the long-term strategy is in progress. In this phase, the Bank will simplify and standardize business processes to gain speed and improve efficiency. This is being done in step with the implementation of new information systems platform that will empower Bank staff to deliver a higher quality of client experience. Initiatives to increase revenues outside Quebec are also underway. While implementing these strategic priorities, the Bank will continue to emphasize strict cost management and adherence to its risk management principles to ensure that revenue growth is balanced with productivity gains and an appropriate risk profile.

Optimize and leverage the new distribution model

Following significant organizational changes aimed at aligning distribution with client needs, including the addition of over 300 client-facing positions, 2010 was a year of execution for the Personal and Commercial segment. Supported by the economic recovery, this segment achieved strong results, with the third and fourth quarters setting records for revenues and net income.

Highlights

- The Bank achieved significant growth in loan volumes and increased its Quebec market share in commercial lending.
- The number of retail and commercial clients increased compared to 2009.
- Insurance activities continued to grow, with a 5% increase in revenues.
- Under its branch modernization program, the Bank renovated or relocated 54 branches in 2010, with an additional 59 upgrades planned for 2011, bringing the three-year total to 152 retail branches.

Build a proactive sales and service culture focused on client needs

The Personal and Commercial segment began 2010 with a client-centric organizational structure, new client segmentation, and a focus on providing each client with the level of financial advice, products and service appropriate to their needs. In Personal Banking, specific offers were developed for each client segment and a new business intelligence group helped client-facing staff offer personalized solutions to retail clients. The Bank introduced a standard approach to sales and relationship building throughout the branch network. In Commercial Banking, the Bank leveraged the presence of small business advisors and SME specialists in its retail branches to offer a higher level of personalized service to those segments. Specialist teams with multidisciplinary experience were created to better serve larger clients by offering more comprehensive, tailored solutions beyond credit and deposit services.

Highlights

- Personal Banking significantly increased the number of proactive contacts with existing clients compared to prior years, resulting in new business and a strong pipeline of opportunities.
- The Bank received a positive response to its new in-branch procedure designed to introduce clients to its complete range of financial solutions, products and services.
- Retail branches became the primary service centre for small business and commercial clients, which translated into excellent growth in business volumes.
- The Bank experienced strong demand for cash management products, a direct result of targeted efforts to clients in need of these services.

Gain speed and efficiency through process simplification and a new sales and service platform

In Phase II of its *One client, one bank* initiative, the Bank will simplify its business processes to achieve important reductions in administrative tasks, turnaround times for credit approvals, and other financial transactions. This is being undertaken in conjunction with the deployment of a new customer relationship management platform across the Personal and Commercial segment. Client-facing staff will have more time for relationship building activities and an advanced tool to assist them in identifying opportunities and offering the best solutions to each client. The anticipated benefits are expected to be felt as each new business process is implemented.

Highlights

- In Personal Banking, simplified processes were introduced for account openings and credit approvals for estate settlements and mortgage loans.
- In Commercial Banking, simplified processes were also implemented for account openings, prequalification for SME financing and credit renewals.

Grow presence outside Quebec

The Bank has begun to apply key elements of the *One client, one bank* initiative to its Personal and Commercial segment outside Quebec. Implementation will continue in 2011 in combination with growth initiatives in selected markets and business sectors.

For the Partnership business—as part of Third-Party Business Solutions—volumes referred from new channels are increasing and should continue to grow rapidly.

Highlights

- A total of 25 new distribution agreements were signed in the past 12 months with various brokers/dealers.

WEALTH MANAGEMENT

OVERVIEW

Wealth Management provides financial advice, investment solutions, products and specialized services to clients through dedicated subsidiaries and business units, internal partners and third parties working seamlessly to deliver an integrated offering.

- National Bank Financial (NBF) is the leading full-service broker in Quebec and among the largest in Canada, with 775 investment advisors in more than 100 service outlets across the country.
- National Bank Direct Brokerage Inc. (NBDB) is one of the largest discount brokers in Canada and a leader in Quebec.
- National Bank Securities Inc. (NBS) designs and distributes the Bank's diverse offering of mutual funds and high interest savings accounts.

- National Bank Private Wealth 1859 provides comprehensive wealth management solutions to the high-net-worth segment.
- As well as being a leader in discretionary asset management, National Bank Trust Inc. (NBT) offers mutual fund administration and securities custody services to institutional investors.
- Innocap Investment Management Inc. (Innocap), a subsidiary held in partnership with BNP Paribas, provides institutional investors with a state-of-the-art operational platform for alternative investment-based managed accounts.
- Natcan Investment Management Inc. (Natcan) delivers a full range of portfolio management services for the Bank's retail investment solutions and for institutional clients.

System Results – Wealth Management

Year ended October 31
(millions of dollars)

	2010	2009	2008	% change 2010-09	% change 2009-08
Excluding specified items⁽¹⁾					
Net interest income	108	127	137	(15)	(7)
Fee-based revenues	395	355	407	11	(13)
Transaction and other revenues	266	275	290	(3)	(5)
Total revenues	769	757	834	2	(9)
Operating expenses	602	588	601	2	(2)
Income before income taxes and non-controlling interests	167	169	233	(1)	(27)
Income taxes	52	53	77	(2)	(31)
Non-controlling interests	3	3	3	–	–
Net income excluding specified items	112	113	153	(1)	(26)
Specified items after taxes ⁽¹⁾	(2)	–	–		
Net income	110	113	153	(3)	(26)
Average assets	940	873	693	8	26
Risk-weighted assets ⁽²⁾	3,194	6,532	4,451	(51)	47
Average deposits	11,534	11,565	9,012	–	28
Efficiency ratio excluding specified items	78.3%	77.7%	72.1%		

(1) See *Financial Reporting Method* on pages 18 and 19.

(2) In 2008, the Bank adopted the rules of the Basel II Accord and, since November 1, 2009, it has been applying the Advanced Internal Rating-Based Approach for credit risk, whereas prior to that date, it had been using the Standardized Approach.

Assets under management or under administration and revenues – Wealth Management

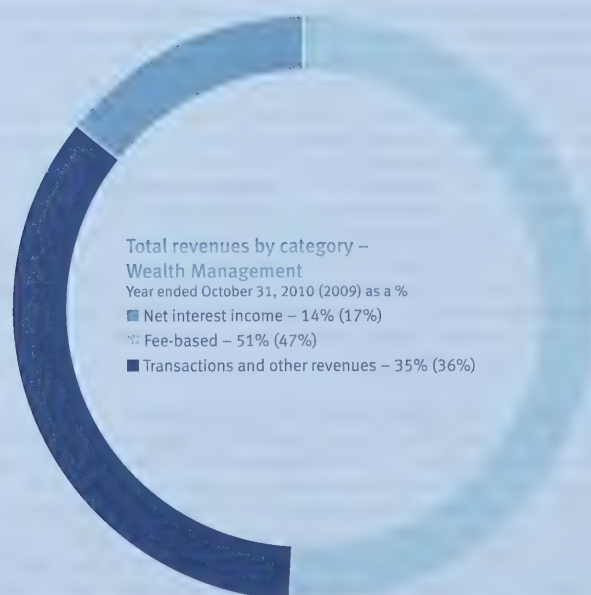
Year ended October 31
(millions of dollars)

	Assets under management or assets under administration			Revenues		
	2010	2009	% change	2010	2009	% change
Individual Investment Services – NBF	58,889	49,967	18	413	388	6
NBCN Inc. (Correspondent Network)	54,929	33,522	64	75	86	(13)
Innocap	1,913	1,976	(3)	14	17	(18)
NBDB	13,580	11,626	17	54	55	(2)
Securities brokerage	129,311	97,091	33	556	546	2
NBS	13,193	11,864	11	179	160	12
Natcan	25,191	24,391	3	51	50	2
NBT	63,775	59,205	8	64	70	(9)
Other	–	–	–	3	3	–
Subtotal	231,470	192,551	20	853	829	3
Intercompany eliminations				(84)	(72)	
Total Wealth Management	231,470	192,551	20	769	757	2

Net income⁽¹⁾
(millions of dollars)



(1) Excluding specified items.



Financial results

Net income excluding specified items for the Wealth Management segment decreased slightly by 1% to total \$112 million compared to \$113 million in 2009. The decrease stems mainly from lower net interest income resulting essentially from historically low interest rates in 2010.

Total revenues were \$769 million, up 2% from \$757 million in 2009 due to a solid 11% growth in fee-based revenues that was driven by strong stock market gains and steady sales performance. These increases offset the combined 7% decrease in net interest income and transaction and other revenues. The assets of individuals under management and under administration increased 20% to total \$231 billion, due to higher market values and the addition of major clients in our Correspondent Network.

Operating expenses stood at \$602 million, a \$14 million or 2% increase resulting mainly from higher variable compensation. As revenues and operating expenses grew at about the same rate, the efficiency ratio dipped slightly, standing at 78.3% versus 77.7% in 2009.

The net income excluding specified items for fiscal 2010 and fiscal 2009 were comparable, but solid growth momentum was observed in the second half of the year; as shown in the graph on the previous page, net income grew 18% between the third and fourth quarter of 2010. The specified items for 2010 consisted of a write-down of management contracts further to impairment tests.

Strategies and achievements

Wealth Management offers excellent business opportunities for the Bank. Individual wealth continues to grow, and an aging population is driving greater demand for financial advice and retirement solutions while many entrepreneurs are facing business transfer decisions that demand expert advice. Although competition is intense, the Bank's objective is to be a larger player in this market by gaining market share in Quebec and expanding its presence across Canada.

The *One client, one bank* initiative is designed to strengthen the Bank's positioning in this important market segment and the early results are positive. Going forward, the Bank's strategic priorities are to build on recent achievements, increase its visibility and brand recognition as a leading provider of wealth management solutions and maintain a comprehensive and competitive line-up of investment solutions and high service levels for each client segment. The Wealth Management segment plays an important role in the Bank's strategy for pursuing revenue growth outside Quebec.

Optimize and leverage internal distribution channels

Through organizational changes, new rules of engagement for referrals between business units, optimized compensation structures, and strong leadership, the Wealth Management segment is forging effective collaboration among its constituent parts. Activities and initiatives are now planned with the objective of providing clients with seamless financial advice, investment solutions and services that meet their needs, regardless of where the relationship was initially developed. Furthermore, the Bank is fostering a common, advice-based approach to wealth management and promoting the emergence of a distinctive brand of client experience. Notable progress was made on several fronts during fiscal 2010.

Highlights

- National Bank Private Wealth 1859, created in 2009 to serve the high-net-worth segment, achieved ambitious targets for number of clients and assets under management. Referrals from National Bank Financial investment advisors and Personal and Commercial Banking were instrumental to this success. Next steps for National Bank Private Wealth 1859 include establishing regional offices in strategic locations both in and outside of Quebec.
- The merging of National Bank Trust and Private Wealth 1859 in mid-year created a stronger business unit with greater expertise and resources to serve a growing client base.
- Referral activity between National Bank Financial investment advisors and Financial Planners in Personal and Commercial Banking resulted in increased cross-selling activities and deeper client relationships.
- Wealth Management worked closely with Personal and Commercial Banking to grow the value of the assets under management through the branch network in a highly competitive environment. The number of joint business development activities increased significantly compared to the previous year.
- A major survey showed that the satisfaction of National Bank Financial (NBF) clients with their advisors increased over the three years ending December 31, 2009, a challenging period from an investment perspective. Reflecting this higher satisfaction rate, National Bank Financial's share of wallet grew by 3% over this same period.

For 2011, the Bank will continue to focus on improving client experience by building on the achievements of the past two years. Continued emphasis will be placed on generating higher referral activity across the Bank.

Increase the Bank's visibility and brand recognition as a leader in retirement planning and wealth management

The Bank's objective is to be the benchmark in the Quebec retirement market and a key player outside Quebec. Significant progress has been made in developing a unified strategy across the Bank, with a common approach to engaging clients using life cycle stages, extensive training and a dynamic website containing useful retirement planning information. Among its current initiatives, the Bank publishes a Retirement Index twice yearly that measures the confidence of Canadians with regard to the financial and emotional dimensions of their retirement as well as an online version of the survey questionnaire that anyone can complete and then compare their results with the index.

To achieve greater recognition for its retirement planning expertise and the quality, efficiency and convenience of its transactional services and credit activities, the Bank is working diligently to increase the visibility of its offering to all client segments. Its efforts include retirement conferences for existing and potential clients, partnerships, sponsorships and advertising.

Highlights

- At the end of 2010, the Bank launched the Retirement Index for Entrepreneurs in order to engage SME business owners in this important aspect of their financial planning.
- New marketing tools were developed for the Bank's branch-based advisors and National Bank Financial investment advisors to convey a unified, advice-based approach to savings and investment, while promoting the full breadth of expertise within National Bank Financial Group. This is a first for the Bank.

Offer competitive investment solutions, products and services for each client segment

Following a major restructuring and streamlining of its products in 2009, the Bank now offers a full line-up of retail investment solutions, which range from basic to highly sophisticated, in order to address the needs of each of its client segments. These solutions are competitive both in terms of fees and performance. In fiscal 2010, the Bank enhanced its offering by making changes to certain mutual fund families and by introducing new products managed by external portfolio managers.

In the institutional market, the Bank continued its efforts to grow assets under management and administration, based on the expertise of Natcan, Innocap and NBT.

Highlights

- Strategic Portfolios, the Bank's most important investment solution in terms of assets under management, was repositioned to offer a better risk/return trade-off and offer a potential for higher returns. This asset allocation service is recommended for clients with \$10,000-\$100,000 to invest.
- The Bank's Managed Portfolios surpassed the \$1.0 billion mark in assets under management. New external managers and new asset classes were added to position this solution even better to serve clients with a minimum of \$100,000 to invest. Managed Portfolios have a competitive fee structure and an investment performance that ranks favourably with their peer group over a wide variety of time periods.
- The Bank was selected by Jarislowsky, Fraser Limited, one of Canada's largest investment managers, as their partner for launching a family of three low-fee mutual funds. Jarislowsky, Fraser will manage the fund portfolios while NBS will be responsible for the legal and administrative aspects.
- Three Natcan-managed investment solutions received Canadian Lipper Fund Awards for superior risk-adjusted performances, and Natcan won an important corporate bond mandate with an institutional client.
- J.D. Power ranked NBDB third among top Canadian discount brokers based on client service, pricing and technology.
- The Bank continued to be a leader in structured products, both in terms of innovation and volume of product sold.

For 2011, the Bank will continue to adjust its product offering to ensure it meets client needs. Continuing efforts will be made to attract new mandates from institutional clients.

Leverage internal and external distribution outside Quebec

Approximately 40% of Wealth Management revenues in fiscal 2010 were generated outside Quebec through both internal and third-party channels. The Bank benefits from NBF's extensive footprint of full-service brokerage offices across Canada and its 442 Personal and Commercial Banking branches. Under the *One client, one bank* initiative, these internal channels are working more closely together to maximize client relationships and continue to be important pillars in the Bank's strategy outside Quebec.

The Bank's presence in the Canadian market is complemented by Third-Party Business Solutions, which operates in three distinct areas. Partnerships offers branded and white-labeled banking products. Advisor Distribution promotes the Bank's investment solutions to over 15,000 independent investment advisors across Canada. *Correspondent Network* (NBCN Inc.) is Canada's premier provider of clearing and brokerage services, serving more than 100 investment management companies. The Bank is seeking incremental revenues from these relationships through an expanded offering of investment solutions, banking products and services, as well as through cross-selling opportunities.

Highlights

- Referrals between NBF investment advisors and the branch network generated new business.
- Loan volumes through the partnership's channel increased in fiscal 2010 following an agreement with Sun Life.
- Launched four years ago, the Bank's Meritage Portfolios, which are sold exclusively through the independent advisor channel, enjoyed one of the mutual fund industry's strongest net asset inflows and topped \$1.0 billion in assets under management. Meritage leads competing solutions over most time periods with regard to the rates of return delivered to investors.
- Several new corporate clients joined the Correspondent Network, including HSBC Inc. and Industrial Alliance Securities Inc., and its assets under administration increased compared to last year.

FINANCIAL MARKETS

OVERVIEW

Financial Markets provides corporate, public sector and institutional clients with banking and investment banking services, as well as giving its clients access to the Canadian capital markets through its fixed income, equities and derivatives business lines.

As the leading investment bank in Quebec with a strong presence across Canada, the Financial Markets segment provides a diverse range of financing solutions, from bank credit to debt and equity. It offers extensive advisory services in the areas of mergers and acquisitions and financing as well as risk management products based on its derivative activities in interest rates, equities, foreign exchange and commodities.

In fixed income and equities, the Bank is a major Canadian player, providing origination, underwriting, distribution, research and liquidity through secondary market activities. Through offices outside Canada, it markets Canadian debt and equities to institutional investors in the United States, the United Kingdom and Continental Europe. The Financial Markets segment is also active in proprietary trading and investment activities.

Segment results – Financial Markets

Year ended October 31
(taxable equivalent basis⁽¹⁾)
(millions of dollars)

	2010	2009	2008	% change 2010-09	% change 2009-08
Excluding specified items⁽¹⁾					
Net interest income	824	790	708		
Other income	565	640	196		
Non-controlling interests	(5)	2	197		
Total revenues	1,384	1,432	1,101	(3)	30
Operating expenses	685	664	634	3	5
Contribution	699	768	467	(9)	64
Provision for credit losses	2	27	2		
Income before income taxes and non-controlling interests	697	741	465	(6)	59
Income taxes	206	227	134	(9)	69
Non-controlling interests	5	1	1	–	–
Net income excluding specified items	486	513	330	(5)	55
Specified items after taxes ⁽¹⁾	(15)	–	57		
Net income	471	513	387	(8)	33
Average assets	92,990	97,805	87,196	(5)	12
Risk-weighted assets ⁽²⁾	19,250	23,886	24,485	(19)	(2)
Average deposits	34,305	32,720	32,833	–	–
Average loans and acceptances (corporate and investment banking only)	5,890	7,072	6,247	(17)	13
Net impaired loans	15	72	35	(79)	106
Net impaired loans as a % of average loans and acceptances	0.3%	1.0%	0.6%		
Efficiency ratio excluding specified items ⁽³⁾	49.5%	46.4%	57.6%		

(1) See *Financial Reporting Method* on pages 18 and 19.

(2) In 2008, the Bank adopted the rules of the Basel II Accord and, since November 1, 2009, it has been applying the Advanced Internal Rating-Based Approach for credit risk, whereas prior to that date, it had been using the Standardized Approach.

(3) Adjusted for gains or losses mainly attributable to third parties.

Financial results

For 2010, net income excluding specified items for the Financial Markets segment totalled \$486 million, down \$27 million from \$513 million in 2009. Total revenues amounted to \$1,389 million, down \$41 million from \$1,430 million in 2009. Including non-controlling interests related to trading activities, revenues totalled \$1,384 million compared to \$1,432 million in 2009.

The decrease in trading activity revenues was mainly due to lower revenues from fixed-income securities, as these revenues had benefited from favourable conditions in 2009, mitigated by higher revenues from equities. Financial market fees increased by more than 7% as activity rebounded, and revenues from banking services increased as well, reflecting a resurgence in corporate activity. Gains on available-for-sale securities totalled \$89 million in 2010, down \$4 million from 2009. Revenues from other activities for 2010 totalled \$262 million, for a \$73 million increase that was mostly related to the activities of Credigy Ltd, a subsidiary active in the purchase and servicing of written-off consumer receivables. This improvement offset the lower contribution from Maple Financial Group Inc.

Excluding specified items, operating expenses stood at \$685 million, up 3% from 2009. The increase in operating expense was mainly due to costs related to the operations of Credigy Ltd as well as transaction-related expenses. Excluding specified items, the efficiency ratio was 49.5% compared to 46.4% in 2009. Specified items of \$22 million (\$15 million net of income taxes) consisted mainly of severance pay incurred as part of the restructuring of certain activities of the investment dealer subsidiary. The provision for credit losses was \$2 million, \$25 million less than in fiscal 2009 due essentially to credit losses that were recovered in fiscal 2010.

Consisting mostly of securities, average assets totalled \$93.0 billion, down \$4.8 billion from \$97.8 billion in 2009. Credit to corporations stood at \$5.9 billion in 2010, down 17% from 2009, as these businesses had greater access to markets for their financing needs.

Revenue breakdown – Financial Markets

Year ended October 31
(taxable equivalent basis⁽¹⁾)
(millions of dollars)

	2010	2009	% change
<i>Adjusted for non-controlling interests</i>			
Trading activity revenues			
Equities	243	205	19
Fixed income	199	388	(49)
Commodities and foreign exchange	85	91	(7)
	527	684	(23)
Financial market fees	244	227	7
Gains on available-for-sale securities, net	89	93	(4)
Banking services	262	239	10
Other	262	189	39
Total	1,384	1,432	(3)

Quarterly results
(taxable equivalent basis⁽¹⁾)
(millions of dollars)

Q4 2010

Total revenues	349
Operating expenses ⁽²⁾	183
Net income ⁽²⁾	119

Q3 2010

Total revenues	319
Operating expenses	177
Net income	98

Q2 2010

Total revenues	345
Operating expenses	165
Net income	125

Q1 2010

Total revenues	371
Operating expenses	160
Net income	144

(1) See *Financial Reporting Method* on pages 18 and 19.

(2) Excluding specified items.

Strategies and achievements

In 2010, the Financial Markets segment pursued its current strategic plan and achieved results in line with its objectives. Increased collaboration and information sharing across business lines and with other Bank divisions is contributing to the segment's results. A further step was taken in 2010 by bringing together expertise in fixed income, equity, derivatives and foreign exchange operations onto one state-of-the-art trading floor in Toronto. Going forward, Financial Markets is staying the course with the three main thrusts of its strategy while closely monitoring the allocation of resources in response to market opportunities and changing client needs.

Recognized market leadership in Quebec

As the market leader in Quebec, Financial Markets will continue to focus on its strengths and deepen its presence throughout the region. Owing to Quebec's unique and well diversified economy, and the Quebec Government's infrastructure investments, Financial Markets is fully utilizing the *One client, one bank* strategy in delivering its full capabilities across the spectrum of Quebec-based companies. This is being achieved through the allocation of resources to provide services that meet the specific needs of Quebec-based clients.

Increase focus on Canadian mid-market companies

Financial Markets is leveraging its differentiation as a responsive solutions provider with a strong balance sheet to deepen relationships with Canadian mid-market companies and generate revenue growth. Organized around client needs, it has the ability to effectively deploy resources from corporate and investment banking, sales, trading, and research to its target sectors in a coordinated fashion. By providing clients with advisory services, integrated solutions for accessing capital markets, and comprehensive risk management solutions, the Financial Markets segment is winning more business from existing clients and from new clients in various industry sectors.

In the energy sector, the Bank has built a strong position in commercial lending, investment banking and risk management products with a large team located in Calgary. Based on its success in this sector, the Bank is looking to broaden its reach into the mining industry using the same client-centric approach. The Bank is also taking steps to consolidate its position in Quebec.

Highlights

Notwithstanding the challenging mergers and acquisition markets in 2010, the Bank closed 27 public transactions. The following examples showcase the Bank's M&A and industry teams' creativity:

- The Bank was engaged by the Board of Directors of a Canadian mining company to assist in exploring financing alternatives for one of its gold copper projects located in British Columbia. These deliberations resulted in the sale of the company to a U.S.-based company for \$650 million. The transaction was financed in part with a concurrent \$312 million sale of a royalty interest to a third mining company.
- The Bank was engaged by the Board of Directors of an oil and gas company to act as lead financial advisor in their acquisition of another Canadian company's upstream business for \$460 million. The Bank subsequently acted as lead in the acquiror's \$560 million refinancing of their bank debt.
- In applying the *One client, one bank* vision, the Bank was awarded one of the very few private equity transactions of the year and acted as financial advisor to the private equity firm in their \$230 million acquisition of a Quebec-based company. In addition, the Bank provided an underwritten acquisition facility to the private equity player to complete this transaction.

In 2010, NBF led or co-led 42 equity offerings on behalf of corporate issuers as well as an additional 19 Managed Retail Products / Structured Retail Product offerings. The following list highlights the Bank's strategic focus:

- In September, NBF co-led a \$50 million convertible debenture offering for a Canadian industrial products company. A direct result of *One client, one bank*, the mandate from this new equity relationship for the firm was won through coordinated Research, Investment Banking, Equity Capital Markets and Corporate Banking coverage.
- NBF co-led a convertible offering in January and a trust unit offering in April, which in aggregate totalled over \$200 million. Having previously led a successful \$45 million equity offering for a junior oil and gas company in January 2010, NBF also led a \$55 million convertible debenture offering in March 2010 for the same client. The proceeds of the offering, in conjunction with existing cash balances, allowed the company to redeem existing, more expensive debentures on attractive terms.
- In August, NBF co-led a very successful \$240 million offering for one of its Managed Retail Products clients. This offering represented one of the largest raises by a closed-end fund in 2010 and paved the way for a subsequent and equally successful \$250 million offering for the same client and for which NBF was co-lead.

Leadership in fixed income

The Bank's fixed income group is well-positioned to serve the growing financing needs of the government sector, with a leadership position in trading and underwriting Crown corporation bonds, provincial bonds and municipal debt. The Bank's gains in corporate underwriting have been equally notable as its corporate debt trading and underwriting achieved new heights in 2010, and its strengths now include a specialized team for infrastructure financing which is recognized as one of the top advisors in the country.

Highlights

Led or joint-led managed 45 deals for 15.2% of all public sector debt issuance, moving up to 4th in 2010 in the Thomson Reuters underwriting league tables from 6th in 2009.

Public sector: Led or joint-led managed

- CDN\$ global issues of Crown corporation bonds
- Domestic offerings by Quebec public issuers and western provinces
- US\$ global issues for provincial issuers

Corporate debt: Joint-led managed

- \$2 billion public pension fund two-tranche offering
- \$500 million provincial utility two-tranche issue
- \$150 million retail grocer deal
- \$100 million utility pipeline

Deploy risk management solutions to corporate and commercial clients

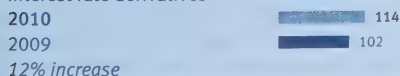
The Bank is working closely with corporate clients to identify their needs and to develop products in all asset classes in order to provide comprehensive risk management solutions. For commercial and SME clients, it has developed a broader offering of risk management solutions that are sold through its advisory channels. As a result of this strategy, the number of corporate and commercial clients actively using interest rate, energy and foreign exchange risk management products has increased significantly.

Number of clients

Energy derivatives



Interest rate derivatives



Foreign exchange

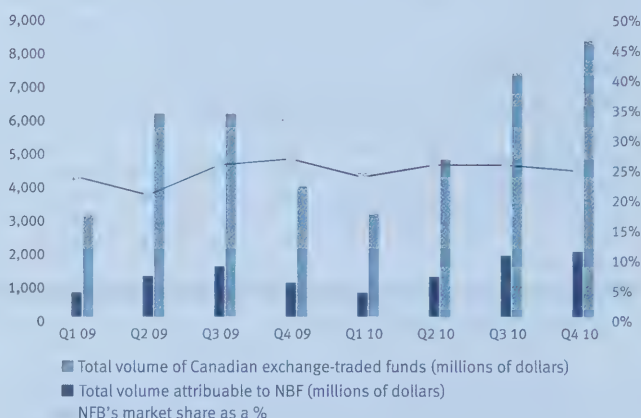


Become the Canadian leader in structured products

Building on its strong position in structured products for retail and institutional investors, the Bank's objective is to maintain its leadership in the Canadian market. It is designing products to meet specific client needs and providing secondary market liquidity through the implementation and maintenance of state-of-the-art trading systems.

Highlights

- The Bank is a designated broker on 37% of all exchange-traded funds (ETF) listed in Canada.
- The Bank was ranked number 2 in secondary trading of ETFs with a 24% market share.



Priorities and outlook for 2011

The Financial Markets segment continues to leverage its current strengths and relationships through focusing on client needs. By focusing on the internal alignment of resources along client lines in 2010 while increasing teamwork and collaboration with other Bank divisions, the Financial Markets segment was well positioned to address the challenges of the competitive environment.

Key priorities for 2011 that will assist the Bank's growth trajectory include re-focusing resources in all targeted sectors for mid-market companies, further solidifying its leadership position in fixed income, deploying risk management solutions to corporate and commercial clients, and continuing its leadership of expanding the market for structured products.

As global economies continue to recover at an uneven pace, investor confidence continues to stabilize. Business investment continues to be a driving force of recovery in the U.S. and Canada, while emerging economies' strong demand for commodities will underpin Canada's continued growth. This environment will result in greater opportunities for Financial Markets' refocused resources.

Financial Markets has a well-diversified business portfolio, allowing it to succeed in these challenging market conditions. The combination of the Bank's client focus along with strong risk management and effective controls has allowed it to consistently generate superior risk-adjusted returns.

OTHER

Segment results – Other

Year ended October 31
(millions of dollars)

	2010	2009	2008
Excluding specified items⁽¹⁾			
Net interest income	(520)	(398)	(320)
Other income	225	233	95
Total revenues	(295)	(165)	(225)
Operating expenses	42	55	22
Provision for credit losses	(65)	(62)	(64)
Loss before income taxes and non-controlling interests	(272)	(158)	(183)
Income tax recovery	(226)	(167)	(191)
Non-controlling interests	55	56	48
Net loss excluding specified items	(101)	(47)	(40)
Specified items after income taxes ⁽¹⁾	(33)	(207)	(228)
Net loss	(134)	(254)	(268)
Average assets	(14,243)	(13,770)	(11,876)

(1) See *Financial Reporting Method* on pages 18 and 19.

The *Other* heading presents revenues and expenses that are not specifically allocated to any one of the Bank's business segments. The data provided in this heading includes securitization operations, certain non-recurring items and the unallocated portion of corporate units such as Information Technology, Sourcing and Organizational Performance; Operations; Human Resources & Corporate Affairs; and Finance, Risk and Treasury.

Financial results

For fiscal 2010, the net loss excluding specified items for the *Other* heading of segment results was \$101 million compared to \$47 million last year. The difference is mostly attributable to lower securitization revenues. The specified items for fiscal 2010 include \$8 million, net of income taxes, in holding charges for the securitized notes of the MAV conduits, a \$75 million administrative penalty, and \$50 million in reversals of provisions for income tax contingencies. In fiscal 2009, the Bank had recorded \$121 million, net of incomes taxes, in holding charges for the restructured notes, and an \$86 million charge, net of income taxes, related to commitments to extend credit to clients holding these restructured notes.

Securitization

The Bank uses securitization as an effective method of financing, transferring risk, and managing capital. The Bank participates in both the Mortgage-Backed Securities Program introduced under the *Canadian National Housing Act* (NHA) and the Canada Mortgage Bond (CMB) Program. The Bank also periodically sells, on a revolving basis, new credit card receivables to a trust to replace receivables that are paid by clients. As at October 31, 2010, the outstanding amount of NHA securities issued by the Bank and sold to third parties totalled \$8.3 billion compared to \$7.5 billion for fiscal 2009. The lower gain from the sale of assets (\$233 million for 2010 compared to \$302 million for fiscal 2009) was mainly due to a lower excess spread on mortgage loans sold during fiscal 2010. See Note 11 to the consolidated financial statements, *Transfers of receivables*, for additional information.

Corporate units

The Information Technology, Sourcing and Organizational Performance units ensure that IT standards and solutions are developed to support the Bank's long-term business aspirations to further increase efficiency of corporate functions aligned with client needs in all sectors.

As for the Operations unit, it is a strategic, proactive and trusted business partner that prioritizes service quality and productivity in order to simplify and enhance the client experience.

The Human Resources & Corporate Affairs units act as trusted business partners in managing human resources, especially in strategy design and implementation of changes within the organization. The units also serve to strengthen the brand and to uphold the Bank's reputation in markets where it conducts business.

As for the Finance, Risk and Treasury units, they provide various specialized services, including strategic and financial planning, financial reporting, tax, capital management, risk management, funding and asset/liability management (Treasury results are included in the Financial Markets segment). The various units support business segments and corporate functions in their financial performance and ensure compliance with regulatory requirements and reporting to stakeholders. See pages 61 to 71 for additional information about risk management.

FINANCIAL ANALYSIS

Analysis of consolidated results

Total revenues

For fiscal 2010, total revenues on a taxable equivalent basis amounted to \$4,484 million, up \$205 million or 5% from fiscal 2009 (see Table 1 on page 74). Excluding the specified items of 2010 and 2009, total revenues on a taxable equivalent basis amounted to \$4,495 million, up \$38 million or 1% from last year.

Net interest income

Net interest income on a taxable equivalent basis totalled \$2,118 million in fiscal 2010 versus \$2,095 million in fiscal 2009 (see Table 2 on page 74), for an increase of \$23 million. Net interest income for the Personal and Commercial segment increased by \$104 million or 7% to total \$1,511 million for fiscal 2010. Loan and deposit volumes experienced steady growth, for a \$4.6 billion increase in average assets, particularly loans and bankers' acceptances and especially with respect to home equity lines of credit. Net interest margin was 2.49% in 2010 compared to 2.51% in 2009 due to a narrowing of the net interest margin on personal deposit products. Net interest income for the Wealth Management segment totalled \$108 million, down \$19 million due to a narrower spread on deposits, particularly in the high-interest account. In the Financial Markets segment, a \$34 million year-over-year increase in net interest income was driven mainly by trading activities and should be examined together with the other items of trading activity revenues. Lastly, the negative net interest income under the *Other* heading increased by \$96 million due to greater securitization activity for mortgage loans and credit card receivables.

Other income

Other income on a taxable equivalent basis totalled \$2,366 million in fiscal 2010 compared to \$2,184 million last year (see Table 3 on page 75). For 2010, there were \$78 million in trading losses allocated to Other income, whereas in 2009, there were trading revenues of \$31 million. Including the portion allocated to net interest income and non-controlling interests, trading revenues totalled \$529 million in 2010, down \$164 million from fiscal 2009 (see Table 4 on page 75). These decreases were the result of market conditions that affected fixed-income securities revenues.

As shown in Table 3 on page 75, underwriting and advisory fees totalled \$268 million in fiscal 2010, a slight \$1 million increase from last year. Securities brokerage commissions stood at \$301 million, up \$19 million due to a rebound in retail brokerage activity. Card service revenues, revenues from lending fees, and revenues from acceptances and letters of credit and guarantee totalled \$356 million in 2010, a \$60 million year-over-year increase that stems from a higher number of mortgage prepayments and an increase in revenues from bankers' acceptances. Revenues from deposit and payment service charges posted a slight \$1 million decrease, totalling \$229 million for fiscal 2010.

An increase in the value of assets under management and administration explains the growth seen in revenues from trust services and mutual funds, which totalled \$374 million in 2010 versus \$327 million in 2009.

Securitization revenues stood at \$289 million, down \$62 million or 18%. The higher volume of securitizations of insured mortgage loans was more than offset by narrower rate spreads in 2010. The Other category of Other income totalled \$284 million, a \$14 million increase owing to increased activity in the Credigy Ltd subsidiary in 2010.

Provision for credit losses

The provision for credit losses was \$144 million in fiscal 2010, a \$161 million decrease (see Table 5 on page 76) that is partly due to a \$126 million allowance for commitments to extend credit to clients holding restructured notes of the MAV conduits that had been recorded in the first quarter of 2009. Recoveries of losses on business credit also contributed to a lower provision for credit losses in 2010.

At \$95 million, the provision for personal credit losses remained the same. The provision for commercial credit losses was \$47 million in fiscal 2010, down \$6 million from 2009. A \$2 million provision for credit losses was taken for corporate financing activities in fiscal 2010 compared to a provision of \$27 million in 2009, with the decrease being due to recoveries. Overall, the specific provision for credit losses in 2010 accounted for 0.24% of average loans and acceptances compared to 0.32% in fiscal 2009, which is an improvement and still relatively low given the current economic environment.

Operating expenses

Operating expenses stood at \$2,811 million in 2010, up \$149 million or 6% from last year (see Table 6 on page 77). Excluding the specified items of 2010 and 2009, operating expenses were up \$49 million or 2%.

Salaries and staff benefits stood at \$1,603 million in 2010, up 4% from last year. Increased staffing needed to implement a new distribution model in the branch network contributed to this increase.

Technology expenses, including amortization, stood at \$364 million, down \$26 million from 2009 as several projects were completed in 2009. Occupancy expenses excluding amortization were also down, decreasing by \$12 million to total \$180 million, partly due to charges for vacant premises that had been recorded in 2009. At \$204 million, professional fees excluding specified items for 2010 increased by \$24 million, mainly due to costs related to the operations of the Credigy Ltd subsidiary. Capital and payroll taxes increased by \$9 million due to the increase in the payroll tax rate in fiscal 2010. The increase in other expenses is explained by the \$75 million administrative penalty recognized as part of a settlement of an ABCP industry-wide agreement.

Income taxes

Detailed information about the Bank's income taxes is provided on pages 155 and 156 in Note 26 to the consolidated financial statements. For fiscal 2010, income tax expense totalled \$221 million, for an effective tax rate of 16.7% compared to income tax expense of \$252 million and an effective tax rate of 21.7% in 2009.

Quarterly financial information

Certain trends and factors have an impact on quarterly earnings, revenues and expenses. A summary of results for the past 12 quarters is provided in the *Quarterly Results* table on pages 72 and 73. The results for the past eight quarters have been affected by various favourable and unfavourable factors.

- Over the past eight quarters, a variety of items have been recognized with respect to the holding of restructured notes of the MAV conduits.
- The results for the first quarter of fiscal 2010 included an administrative penalty paid as part of a settlement of an ABCP industry-wide agreement.
- The results for the first quarter of fiscal 2010 also included the reversal of an income tax provision that was recorded following a revaluation of income tax contingencies.
- During the fourth quarter of 2010, the Bank recorded a restructuring charge, an impairment of an intangible asset, and a reversal of a provision for income tax contingencies.

Over the past eight quarters, consolidated net income has been positive, with certain quarters posting record net income. These results demonstrate sustained performance in the business segments, despite a more difficult economic context in 2009. Effective cost management also helped to maintain this trend.

Over the past two quarters of 2010, net interest income has increased, after retreating significantly in the third quarter of 2009. This growth is mainly attributable to steady loan volume growth in the Personal and Commercial segment.

Other income has increased since the third quarter of 2009. During the third and fourth quarters of 2009, the increase was mainly attributable to trading activity revenues. For the four quarters of 2010, the stability in *Other income* has been more attributable to net gains on available-for-sale securities and to trust services and mutual fund fees. The provision for credit losses has trended downward over the past four quarters owing to the excellent quality of the loan portfolio. The increase in the provision for credit losses in the first quarter of 2009 was mainly due to the provision for the credit facilities that had been granted to clients holding restructured notes of the MAV conduits. Operating expenses fluctuated over the quarters, as various specified items were recorded and salaries and staff benefits increased following the hiring of new personnel. Non-controlling interests remained relatively stable in 2009 and 2010, as did the income tax rate over the past eight quarters, except for the fourth quarter of 2010, when it decreased considerably due to the reversal of a provision for income tax contingencies and to higher tax exempt income. In addition, income tax recoveries had been recorded in the first quarter of 2009 due to the recognition of holding charges on restructured notes of the MAV conduits, whereas in the first quarter of 2010, the reversal of a tax provision following a revaluation of income tax contingencies was offset by the tax impacts of the administrative penalty paid as part of the settlement of an ABCP industry-wide agreement.

For additional information about the fourth quarter of fiscal 2010, visit the Bank's website at www.nbc.ca or the SEDAR website at www.sedar.com to consult the Press Release for the fourth quarter of 2010, filed on November 30, 2010.

Analysis of Consolidated Cash Flows

Due to the nature of the Bank's business, most of its revenues and expenses are cash items. Moreover, certain activities, such as trading activities, generate significant cash flow movements that can impact certain assets and liabilities, including held-for-trading securities, securities sold short, or securities sold under repurchase agreements.

In fiscal 2010, cash and cash equivalents decreased by \$0.1 billion compared to a \$1.3 billion decrease in 2009. As at October 31, 2010, cash and cash equivalents totalled \$2.0 billion versus \$2.1 billion at the same date last year.

Operating activities required \$5.5 billion in cash in 2010, mainly due to a \$6.3 billion increase in held-for-trading securities due to growth in equity securities as part of business strategies on the financial markets. In 2009, operating activities had required \$0.4 billion in cash, mainly due to a \$3.1 billion increase in held-for-trading securities offset by a \$0.6 billion increase in amounts due to clients, dealers and brokers and a \$1.6 billion change in other items.

Financing activities generated cash inflows of \$11.5 billion, mainly due to a \$6.6 billion increase in deposits, primarily business and government deposits, and to a \$5.1 billion change in obligations related to securities sold short. In 2009, financing activities had generated cash inflows of \$1.6 billion, mainly due to a \$5.6 billion increase in securities sold under repurchase agreements, partly offset by a \$2.6 billion decrease in obligations related to securities sold short and a \$0.9 billion decrease in deposits.

Investing activities required \$6.2 billion in cash for fiscal 2010, mainly due to a \$9.0 billion increase in loans, partly mitigated by \$4.8 billion in proceeds from securitization of new assets and other transfers of receivables. Securities purchased under reverse repurchase agreements required \$3.2 billion in cash, whereas the decrease in available-for-sale securities generated \$2.2 billion in cash. In 2009, investing activities had generated \$2.5 billion in cash. The \$4.1 billion in securitization proceeds was used to fund a portion of the \$5.3 billion growth in loans, while the \$1.4 billion increase in available-for-sale securities accounted for the remainder of the use of funds.

Analysis of the Consolidated Balance Sheet

As at October 31, 2010, the Bank had total assets of \$145.3 billion compared to \$132.1 billion at year-end 2009, (see the Consolidated Balance Sheets on page 88), for a 10% increase that stems mainly from securities, securities purchased under reverse repurchase agreements, and loans and acceptances.

Cash and deposits with financial institutions

Cash and deposits with financial institutions totalled \$2.3 billion as at October 31, 2010, virtually unchanged from the Consolidated Balance Sheet amount of 2009. A description of the Bank's liquidity risk management practices is provided on pages 69 and 70 of this Annual Report.

Securities

As at October 31, 2010, securities totalled \$54.3 billion (representing 37% of total assets), rising \$4.1 billion from \$50.2 billion as at October 31, 2009. Available-for-sale securities, i.e., securities generally held long term, totalled \$11.0 billion at year-end, down \$2.2 billion from October 31, 2009, with the decrease being attributable to the sale of \$3.1 billion in securities issued or guaranteed by the Government of Canada, partly offset by a purchase of securities issued or guaranteed by the provinces. Held-for-trading securities increased \$6.3 billion since last year due to growth in equity securities as part of business strategies on the financial markets. The Bank's market risk management policies are described on pages 67 to 69 of this Annual Report. Lastly, securities purchased under reverse repurchase agreements totalled \$10.9 billion as at October 31, 2010, a \$3.3 billion increase since October 31, 2009.

Loans and acceptances

Accounting for more than 43% of total assets, loans and acceptances amounted to \$63.1 billion as at October 31, 2010, for an increase of \$4.8 billion or 8%.

Residential mortgage loans outstanding totalled \$15.8 billion as at October 31, 2010, up \$0.8 billion despite a \$0.9 billion increase in securitized loans and a \$0.5 billion increase in mortgage-backed securities retained. As at October 31, 2010, mortgage loans, including securitized loans and other transfers, amounted to \$25.4 billion versus \$23.2 billion as at October 31, 2009. This growth was mainly due to a robust residential real estate market.

Personal loans and credit card receivables totalled \$20.5 billion at year-end 2010, up 12% from \$18.3 billion at year-end 2009. This substantial increase was due to higher volumes of various consumer credit products and to home equity lines of credit. At \$1.9 billion (before securitization), credit card receivables were unchanged from year-end 2009. As at October 31, 2010, the Bank had securitized \$1.4 billion in credit card receivables, an increase of \$0.2 billion from last year.

Totalling \$26.8 billion at October 31, 2010, loans and acceptances to businesses and government consisted mostly of \$17.3 billion in loans to small and medium-sized enterprises, for an approximate \$1.5 billion increase since year-end 2009. At \$6.2 billion at year-end 2010, loans and acceptances to large corporations were down 11% since year-end 2009, as these corporations had greater access to financial markets for their financing needs.

Table 8 on page 79 provides information about loans by industry type as at October 31, 2010, 2009 and 2008 and as at September 30 for the years 2007 and 2006. The proportion of residential mortgage loans to total loans has been decreasing since 2006 and stood at 27.3% in 2010 versus 28.1% in 2009. Personal loans now account for 35.5% of total loans versus 34.3% in 2009. The main reason for these changes was the popularity of home equity lines of credit over conventional residential mortgage loans. As for business loans, both the transportation and communications sector and the financial institutions sector saw their shares in the loan portfolio grow from 2.2% and 5.7%, respectively, in 2009 to 2.5% and 6.2% in 2010. The mines, quarries and energy sector, on the other hand, represented only 1.3% of the loan portfolio as at October 31, 2010 compared to 2.1% a year earlier.

Impaired loans

Gross impaired loans totalled \$369 million as at October 31, 2010 versus \$407 million as at October 31, 2009, for a decrease of 9% (see Table 9 on page 79). Impaired loans accounted for 6.7% of adjusted tangible capital and allowances, for a decrease of 1.6% compared to October 31, 2009. Impaired loans net of specific allowances decreased \$61 million from a year ago, totalling \$162 million as at October 31, 2010. This decrease comes from credit granted to corporations.

A detailed description of the Bank's credit risk management practices is provided on pages 62 to 66 of this Annual Report as well as in Note 5 to the consolidated financial statements.

Other assets

As at October 31, 2010, other assets amounted to \$14.7 billion compared to \$13.7 billion at the same date in 2009. Other assets consist mainly of the fair value of derivative financial instruments, premises and equipment, goodwill, intangible assets, amounts due from clients, dealers and brokers, and other assets. The \$1.0 billion increase stems mainly from an increase in the fair value of derivative financial instruments, which totalled \$8.1 billion as at October 31, 2010 versus \$7.5 billion at the same date a year earlier.

Deposits

Deposits totalled \$81.8 billion, up \$6.6 billion or 9% from last year. Personal deposits of \$34.1 billion, as shown in Table 10 on page 80, accounted for 42% of all deposits, for a slight \$0.5 billion decrease from the personal deposit balance on October 31, 2009. This decrease is indicative of investors' preference for off-balance sheet products. An overview of total personal savings is provided on page 48.

As at October 31, 2010, commercial deposits totalled \$17.3 billion, down \$1.1 billion from last year as businesses used their liquidity. At \$30.4 billion, purchased funds increased by \$8.2 billion from \$22.2 billion at October 31, 2009, as the Bank pursued its growth strategy in trading and credit activities. In 2010, part of the growth in purchased funds came from the United States, up \$0.8 billion since October 31, 2009 to stand at \$7.9 billion at year-end 2010.

Other liabilities

Other liabilities, excluding acceptances, totalled \$47.1 billion as at October 31, 2010, up 13% or \$5.6 billion from \$41.5 billion last year. This increase was mainly the result of a \$5.1 billion increase in obligations related to securities sold short compared to fiscal 2009.

Subordinated debentures and other contractual obligations

Subordinated debentures stood at \$2.0 billion at year-end, a \$16 million increase since October 31, 2009 that is attributable to the change in the adjustment to the carrying value of debentures covered by a fair value hedge.

Contractual obligations

As at October 31, 2010
(millions of dollars)

	Less than 1 year	1 to 3 years	3 to 5 years	Over 5 years	Total
Long-term financing	1,767	375	1,595	20	3,757
Subordinated debentures ⁽¹⁾	—	—	—	1,894	1,894
Obligations under leases for premises, equipment and furniture, contracts for outsourced IT services, and other contracts ⁽²⁾	533	738	425	564	2,260
	2,300	1,113	2,020	2,478	7,911

(1) At nominal value.

(2) The majority of these commitments are related to operating leases.

Non-controlling interests

Non-controlling interests increased \$2 million from a year ago, totalling \$1.2 billion as at October 31, 2010. This change was mainly due to higher non-controlling interests in consolidated mutual funds, in accordance with the application of AcG-15 due to investments made in new funds. This increase was offset by lower interests in other consolidated entities in accordance with the application of AcG-15, as certain Innocap Investment Management Inc. funds no longer met the consolidation criteria. For additional information, see the *Special Purpose Entities* table on page 52 and Note 21 to the consolidated financial statements.

Shareholders' equity

As at October 31, 2010, the Bank's shareholders' equity was \$7.2 billion compared to \$6.5 billion as at October 31, 2009. The Consolidated Statements of Changes in Shareholders' Equity, which appears on page 91 of this Annual Report, presents the items that make up shareholders' equity. The increase comes mainly from net income, net of dividend payments, and from the reinvestment of dividends into common shares.

As at October 31, 2010, the Bank had 162.8 million common shares issued and outstanding compared to 161.2 million a year earlier. The Bank did not repurchase any common shares during the year. In addition, six series of preferred shares were outstanding at year-end. The table below provides the capital stock details.

Shares and stock options

As at October 31, 2010

	Number of shares	\$ million
First Preferred Shares		
Series 15	8,000,000	200
Series 16	8,000,000	200
Series 20	6,900,000	173
Series 21	8,050,000	201
Series 24	6,800,000	170
Series 26	5,800,000	145
	43,550,000	1,089
Common shares	162,771,816 ⁽¹⁾	1,804
Stock options	8,485,086 ⁽¹⁾	

(1) As at November 26, 2010, there were 162,548,262 common shares and 8,470,111 stock options outstanding.

Regulatory capital

Since November 1, 2009, the Bank has been following the Advanced Internal Rating-Based Approach (AIRB Approach) for credit risk, whereas before that date, it had been using the Standardized Approach. For operational risk, the Bank uses the Standardized Approach and, for market risk, it continues to use the models and the Standardized Approach in accordance with the Basel II Accord.

According to the rules of the Bank for International Settlements (BIS)—Basel II—and using the AIRB Approach for credit risk, the Tier 1 capital ratio and the total capital ratio stood at 14.0% and 17.5%, respectively, as at October 31, 2010; as at October 31, 2009, under the Standardized Approach of Basel II, these same ratios were 10.7% and 14.3%, respectively. This increase in the capital ratios was largely due to the Bank's adoption of the AIRB Approach as well as to the growth in retained earnings. The risk-weighted assets calculated under the rules of Basel II decreased and amounted to \$49.8 billion as at October 31, 2010 compared to \$58.6 billion as at October 31, 2009.

The same ratios under the old BIS rules (Basel I) would have been 12.1% and 15.6%, respectively, as at October 31, 2010, as against 11.5% and 15.2% as at October 31, 2009. Under Basel I, risk-weighted assets would have been \$58.9 billion as at October 31, 2010.

Capital management standards and procedures are explained in greater detail on pages 58 to 60 of this Annual Report. Additional information about capital management is provided in Tables 11 to 14 on pages 80 to 83 as well as in Note 6 to the consolidated financial statements.

Related party transactions

The Bank grants loans to its directors and officers under various conditions. Loans to eligible officers are granted under the same conditions as those applicable to loans granted to any other employee of the Bank. The principal conditions are as follows: the employee must meet the same credit requirements as a client; mortgage loans are granted at the posted rate less 2%; personal loans bear interest at the client rate divided by two; credit card advances bear interest at a prescribed fixed rate in accordance with Bank policy; and personal lines of credit bear interest at the Canadian prime rate less 3%, but never lower than Canadian prime divided by two. The amounts granted by the Bank to its directors and officers are not material.

For personal loans and personal lines of credit, employees may not borrow more than 50% of their annual gross base salary at the reduced rate. The Canadian prime rate is applied to the remainder.

Moreover, in accordance with the *Bank Act* (Canada), the aggregate of loans granted to an officer of the Bank, excluding a mortgage loan granted on the officer's principal residence, cannot exceed twice the officer's base salary.

In the normal course of business, the Bank provides various banking services and concludes contractual agreements and other transactions with companies over which it has significant influence as well as with directors and officers under conditions similar to those offered to non-related third parties. These agreements did not have a significant impact on the Bank's results.

Moreover, the Bank offers the Deferred Stock Unit Plan to directors who are not Bank employees. For additional information, see Note 24 to the consolidated financial statements.

Master asset vehicles

As at October 31, 2010, the face value of the restructured notes of the master asset vehicle (MAV) conduits held by the Bank was \$1,926 million (\$1,954 million as at October 31, 2009), of which \$1,664 million was designated as *Held-for-trading securities* under the fair value option, and an amount of \$262 million was classified in *Available-for-sale securities* (\$1,685 million designated as *Held-for-trading securities* and \$269 million classified in *Available-for-sale securities* as at October 31, 2009). During fiscal 2010, the Bank received capital repayments related to the restructured notes of the MAV conduits, certain restructured notes were taken back from clients with credit facilities backed by these notes, and certain notes held were written off.

The table below provides a breakdown of the face value of the restructured notes of the MAV conduits (which replaced asset-backed commercial paper ABCP under the restructuring plan for these instruments) held by the Bank:

As at October 31 (millions of dollars)	2010	2009
MAV I		
Class A-1	601	604
Class A-2	553	553
Class B	94	94
Class C	39	39
IA tracking notes for ineligible assets	44	77
Total MAV I	1,331	1,367
MAV II		
Class A-1	106	98
Class A-2	87	79
Class B	18	14
Class C	7	6
IA tracking notes for ineligible assets	12	11
Total MAV II	230	208
MAV III		
TA tracking notes for traditional assets	53	85
IA tracking notes for ineligible assets	171	148
Total MAV III	224	233
ABCP not included in the Pan-Canadian restructuring plan	141	146
Total	1,926	1,954

As part of the Montreal Accord restructuring, swap counterparties to MAV I and MAV II agreed to an 18-month post-closing moratorium period during which time margin calls could not occur. On July 16, 2010, the moratorium period expired. As a result, certain transactions held by the MAVs are now exposed to collateralization triggers. The Bank has committed to contribute \$911 million to a margin funding facility in order to finance potential collateral calls. As at October 31, 2010, no amount had been advanced by the Bank.

Establishing fair value

The carrying value of the restructured notes of the MAV conduits held by the Bank in an investment portfolio as at October 31, 2010, designated as *Held-for-trading securities*, was \$1,147 million, and \$53 million was classified in *Available-for-sale securities* (\$1,147 million designated as *Held-for-trading securities* and \$78 million classified in *Available-for-sale securities* as at October 31, 2009). The notes held in an investment portfolio with one or more embedded derivatives were designated as *Held-for-trading securities* under the fair value option, and the other notes were classified in *Available-for-sale securities*. The Bank took back restructured notes of the MAV conduits related to the credit facilities at a fair value of \$36 million during the year ended October 31, 2010. The table below provides a breakdown of the carrying value of the restructured notes of the MAV conduits held by the Bank:

Contractual maturities

As at October 31
(millions of dollars)

	2010		
	1 to 5 years	More than 5 years	Total
MAV I and MAV II	6	1,112	1,118
MAV III	6	38	44
ABCP not included in the Pan-Canadian restructuring plan	15	23	38
Carrying value of the notes	27	1,173	1,200
Margin funding facilities	–	(55)	(55)
Total	27	1,118	1,145

As at October 31
(millions of dollars)

	2009		
	1 to 5 years	More than 5 years	Total
MAV I and MAV II	6	1,103	1,109
MAV III	24	48	72
ABCP not included in the Pan-Canadian restructuring plan	19	25	44
Carrying value of the notes	49	1,176	1,225
Margin funding facilities	–	(63)	(63)
Total	49	1,113	1,162

In establishing the fair value of the restructured notes of the MAV conduits and excluding ineligible assets, the Bank considered the quality of the underlying assets. The Bank determined the fair value using a discounted cash flow analysis. The discount rate is based 80% on the CDX.IG index tranches and 20% on a basket of securities backed by assets such as credit card receivables, Residential Mortgage-Backed Securities (RMBS), Commercial Mortgage-Backed Securities (CMBS) and automobile loans. Credit ratings and coupons are based on the terms set out in the restructured notes of the MAV conduits. Maturities are based on the anticipated cash flows of the underlying assets.

For ineligible assets, the fair value of the tracking notes is based on an analysis of the underlying assets of the notes and the market value of comparable instruments. For RMBS, fair values were based on the ABX index; for CMBS, CMBS indices, including the CMBX index, were chosen. As for derivative financial instruments, the Bank used valuation models which are commonly used by market participants with inputs that are based on factors observable in the markets: CDX.IG indices, base correlation and interest rates.

To determine the value of the restructured notes of the MAV conduits it is holding, the Bank compares the value obtained using the previously described methodology against a range of values. The values situated in this range were obtained from third parties and are adjusted to take liquidity into consideration. As several assumptions may be used in determining fair value, this range reflects the level of uncertainty associated with these models.

Since the carrying value of the restructured notes of the MAV conduits held by the Bank was within the range of the estimated fair value as at October 31, 2010, no change was made to the carrying value as at October 31, 2010. On September 21, 2010, the ratings of MAV I and MAV II Class A-1 notes were upgraded to “A (high) (sf)” from “A (sf),” and the ratings were removed from “under review with positive implications” where they had been placed on June 22, 2010. At the same time, the ratings on MAV I and MAV II Class A-2 notes were maintained at “A (sf)” and “BBB (low) (sf).”

The Bank's valuation was based on its assessment of the conditions prevailing as at October 31, 2010, which may change in subsequent periods. The most important assumptions to determine the fair value of the restructured notes are observable discount rates and the credit ratings of the notes. The sensitivities of these assumptions on fair value as at October 31, 2010 are as follows:

- A 10-basis-point change in the discount rate would result in a \$9 million decrease or increase in the fair value;
- A decrease in the credit rating of one letter grade would result in a decrease in the fair value between a range of \$45 million to \$80 million; and
- An increase in the credit rating by one letter grade would result in a fair value increase within a range of \$40 million to \$50 million.

Determining the fair value of the restructured notes of the MAV conduits is complex and requires an extensive process that includes the use of quantitative modelling and relevant assumptions. Factors that could have a significant impact on the future value include (1) changes in the value of the underlying assets, (2) changes regarding the liquidity of the restructured notes of the MAV conduits that are not currently traded on an active market, (3) the impacts of a marked and prolonged economic slowdown in North America, and (4) changes in legislation.

Credit facilities to clients holding restructured notes of the MAV conduits

As at October 31, 2010, credit facilities outstanding provided to clients holding restructured notes of the MAV conduits stood at \$143 million (\$285 million as at October 31, 2009) and the allowance for credit losses was \$121 million (\$148 million as at October 31, 2009). In total, the collateral related to the credit facilities offered to clients is estimated as follows:

Collateral As at October 31, 2010 (millions of dollars)	Face value of the notes	Credit facilities backed by IA tracking notes ⁽¹⁾	Credit facilities backed by restructured notes of the MAV conduits ⁽²⁾
MAV II			
Class A-1	302	–	244
Class A-2	277	–	225
Class B	50	–	41
Class C	19	–	15
IA tracking notes for ineligible assets	107	70	–
Total MAV II	755	70	525
MAV III			
TA tracking notes for traditional assets	15	–	13
IA tracking notes for ineligible assets	110	79	–
Total MAV III	125	79	13
Total	880	149	538

Collateral As at October 31, 2009 (millions of dollars)	Face value of the notes	Credit facilities backed by IA tracking notes ⁽¹⁾	Credit facilities backed by restructured notes of the MAV conduits ⁽²⁾
MAV II			
Class A-1	423	–	327
Class A-2	405	–	311
Class B	73	–	56
Class C	28	–	22
IA tracking notes for ineligible assets	130	94	–
Total MAV II	1,059	94	716
MAV III			
TA tracking notes for traditional assets	45	–	27
IA tracking notes for ineligible assets	156	130	–
Total MAV III	201	130	27
Total	1,260	224	743

(1) These credit facilities represent 75% of the face value of the notes and are guaranteed by the notes, less repayment of their capital.

(2) These credit facilities represent 75% of the face value of the notes, of which 30% are full recourse to the borrower and 45% guaranteed by the notes, less repayment of their capital.

Regulatory investigation

On December 21, 2009, the Bank's investment dealer subsidiary, National Bank Financial (NBF), agreed to a settlement of \$75 million with the Autorité des marchés financiers du Québec (AMF). This agreement is one of a series of agreements concluded between securities regulators and financial institutions involved in third-party ABCP in 2007. The settlement amount was recorded as a charge in *Operating expenses – Other* in the Consolidated Statement of Income for fiscal 2010.

An administrative penalty of \$70 million, plus \$1 million in investigation costs, was paid to the AMF. As part of its communication programs, the Bank has also agreed to invest \$4 million in a financial literacy campaign for the benefit of public investors over the next two years. This program is a complement to the AMF's own efforts at investor education.

OFF-BALANCE SHEET ARRANGEMENTS

In the normal course of business, the Bank is party to various financial arrangements that, under Canadian GAAP, are not required to be recorded on the Consolidated Balance Sheet or are recorded under amounts other than their notional or contractual values. These arrangements include, among others, assets under administration and assets under management, transactions with variable interest entities, derivative financial instruments, the issuance of guarantees, the margin funding facility of the MAV conduits, credit instruments, and financial assets received as collateral.

Assets under administration and assets under management

As at October 31, 2010, total assets under administration and assets under management amounted to \$231.5 billion, for a year-over-year increase of \$38.9 billion or 20%. A table on page 33 provides a detailed breakdown of the Wealth Management segment.

Client assets administered or managed by the Bank's Correspondent Network amounted to \$54.9 billion, a substantial year-over-year increase of 64% due to a rebound in activity. The investment dealer subsidiaries reported 18% or \$8.9 billion growth in NBF Individual Investment Services and 17% or \$2.0 billion growth at NBDB, the discount brokerage subsidiary. These increases are attributable to the recovery in stock markets since the start of the year.

Assets administered or managed by Natcan continued to grow, rising 3% to total \$25.2 billion, also because of the rebound in stock markets.

As at October 31, 2010, personal savings under administration totalled \$118 billion, up 11% from \$106 billion as at October 31, 2009. The assets of NBF's clients accounted for approximately 56% of these savings, while 29% were made up of bank deposits. Overall, off-balance sheet personal savings stood at \$84 billion, up \$13 billion or 18% year-over-year. This increase was primarily due to growth in the stock market.

Total personal savings

As at October 31
(billions of dollars)

	2010	2009	% change
Deposits	34	35	(3)
Full-service brokerage	66	46	43
Mutual funds	13	12	8
Other	5	13	(62)
Total personal savings	118	106	11

Variable interest entities (VIEs)

VIEs are entities in which holders of equity investments at risk do not have a controlling financial interest or where the equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support provided by other parties. Accounting Guideline No. 15, *Consolidation of Variable Interest Entities* (AcG-15) of the Canadian Institute of Chartered Accountants (CICA) Handbook sets out the consolidation principles applicable to VIEs. AcG-15 requires the consolidation of a VIE by its primary beneficiary, defined as the party that absorbs the majority of the entity's expected losses, receives the majority of the entity's expected residual returns, or both.

The Bank uses VIEs to diversify its funding sources and manage its capital requirements by securitizing its own assets, namely residential mortgages and credit card receivables, and issuing innovative capital instruments. The Bank also uses one of these entities to offer services to clients, such as assisting them in securitizing their financial assets or providing them with investment opportunities.

For additional information on VIEs, refer to the *Additional Disclosure – Financial Stability Board* section on pages 51 and 52 of this Annual Report.

Securitization programs

Securitization involves selling receivables to a trust, which funds the purchase by issuing term bonds or commercial paper. Sales of receivables are most often accompanied by a credit enhancement so that the bonds or commercial paper may benefit from higher credit ratings. This enhancement takes the form of first-loss protection at the expense of the party selling the receivables, and second-loss protection assumed by a third party. First-loss protection is usually composed of two elements: 1) the excess interest, i.e., the difference between the interest received on the receivables and the interest due to investors plus expenses related to the securitization program and 2) an escrow account deposit, if required. Second-loss protection may be assumed directly by a loan guarantor or indirectly by a subordinate class.

Securitization programs often feature interest rate swap agreements and liquidity guarantee arrangements in order to guarantee interest payments and payment of principal to investors.

Securitization of the Bank's financial assets

The Bank has set up the Canadian Credit Card Trust (CCCT), a securitization program for its own assets. This VIE is a qualifying special purpose entity under CICA Accounting Guideline No. 12, *Transfers of Receivables*, and is thus expressly exempt from consolidation under AcG-15. The Bank also participates in two Canada Mortgage and Housing Corporation (CMHC) securitization programs: the Mortgage-Backed Securities Program under the *National Housing Act* (Canada) (NHA) and the Canada Mortgage Bond (CMB) Program. These programs are tools for managing liquidity, capital and risk.

In all the securitization programs used for its own assets, the Bank acts as the servicer of the receivables sold, maintaining its relationships with clients. Furthermore, it administers the securitization programs and ensures that all related procedures are stringently followed and that investors are paid according to the provisions of these programs. Under the program, the Bank may also be asked to act as counterparty in interest rate swap agreements and, if required, may provide first-loss protection.

Gains or losses on the Bank's asset securitization transactions and servicing revenues from the sold receivables are presented in the Consolidated Statement of Income under *Securitization revenues*. A more detailed description of these revenues is provided in Note 11 to the consolidated financial statements.

The Bank may retain certain interests in the securitized receivables in the form of subordinated certificates, rights to future excess interest and, in some cases, a cash reserve account. Retained interests are recognized at their fair value and included in *Available-for-sale securities* in the Consolidated Balance Sheet. The assumptions related to the fair value of retained interests are periodically reviewed, and any other-than-temporary decline in fair value is recorded in the Consolidated Statement of Income. The impact of securitization transactions on the Consolidated Balance Sheet is described in Note 11 to the consolidated financial statements.

The following is a detailed description of the Bank's asset securitization programs:

Securitization of credit card receivables

As at October 31, 2010, the credit card receivables portfolio that the Bank sold to CCCT (net of the Bank Certificate held by the Bank) represented an amount outstanding of \$1.4 billion. CCCT issued investors' certificates in the same amount, \$1.3 billion of which are held by third parties and \$0.1 billion are held by the Bank and presented in *Available-for-sale securities* in the Consolidated Balance Sheet. New credit card receivables are periodically sold to the structure on a revolving basis to replace the receivables reimbursed by clients. The different series of certificates are rated by the DBRS Limited and Standard & Poor's Corporation.

From this portfolio of sold receivables, the Bank retains the excess spread, i.e., the residual net interest income after all the expenses related to this structure have been paid. This excess spread is used to cover any losses on the portfolio and thus serves as first-loss protection. The fair value of the excess spread is recorded on the Consolidated Balance Sheet as a retained interest. Furthermore, second-loss protection for issued series is provided by certificates subordinated to the senior notes, representing 5.5% (Series 2005-2 and 2008-1) and 6.25% (Series 2010-1) of the total amount of the series issued. This securitization program does not feature interest rate swap agreements or liquidity guarantee arrangements.

The Bank uses the CCCT program to manage its capital requirements as it reduces the Bank's risk-weighted assets and consequently improves its regulatory capital ratios.

NHA Mortgage-Backed Securities and Canada Mortgage Bond programs

The Bank participates in the NHA Mortgage-Backed Securities (NHA-MBS) Program and, since its inception in June 2001, has participated in the Canada Mortgage Bond (CMB) Program. Under the latter program, lenders sell NHA securities to Canada Housing Trust (CHT), which finances the purchase through the issuance of mortgage bonds insured by CMHC. Moreover, these mortgage bonds feature an interest rate swap agreement under which a CMHC-certified counterparty pays CHT the interest due to investors and receives the interest on the NHA securities.

As at October 31, 2010, the outstanding amount of NHA mortgage-backed securities issued by the Bank and sold to third parties was \$8.3 billion. The mortgage loans sold consist of fixed or variable rate residential loans that are insured against potential losses by a loan insurer. In accordance with the NHA-MBS Program, the Bank advances the funds required to cover late payments and, if necessary, obtains reimbursement from the insurer that insured the loan in default.

The NHA-MBS Program and the CMB Program do not use liquidity guarantee arrangements. The Bank uses these securitization programs mainly to diversify its funding sources. The Bank does not use these programs to manage its capital requirements. This is because they do not have a significant impact on the Bank's risk-weighted assets, since substantially all NHA securities issued by the Bank are backed by mortgage loans insured by CMHC. The sale of NHA securities issued by the Bank therefore has no significant impact on the Bank's regulatory capital ratios.

Securitization of third-party financial assets

The Bank administers a multi-seller conduit that purchases various financial assets from clients and finances those purchases by issuing asset-backed commercial paper. Clients use this multi-seller conduit to diversify their sources of financing and reduce funding costs, while continuing to service the financial assets and providing a certain amount of first-loss protection. The Bank acts as a financial agent and provides administrative and transaction structuring services to this conduit. The Bank provides backstop liquidity and credit enhancement facilities under the commercial paper program. These facilities are presented and described in Note 28 to the consolidated financial statements. The Bank holds significant variable interests in this conduit due to the following: backstop liquidity and credit enhancement facilities provided to the conduit, collection of fees as a financial agent and administrator, and participation in the commercial paper program. However, the Bank is not required to consolidate the entity under AcG-15, as it does not have to absorb the majority of the conduit's expected losses or receive the majority of the conduit's expected residual returns.

In order to meet the needs of investors, the Bank has concluded derivative contracts with this conduit, the fair value of which is presented on the Bank's Consolidated Balance Sheet. The total assets of the conduit were \$1,152 million as at October 31, 2010 (\$494 million as at October 31, 2009).

NBC Capital Trust

On June 15, 2006, the Bank issued an innovative instrument in the form of 225,000 transferable non-voting trust units called Trust Capital Securities-Series 1, or NBC CapS – Series 1, via NBC Capital Trust (the Trust), an open-ended trust established during fiscal 2006.

The gross proceeds of \$225 million from the offering were used by the Trust to acquire a deposit note from the Bank. Since the Bank does not consolidate the Trust, the deposit note is presented on the Consolidated Balance Sheet under *Deposits*.

Each \$1,000 of principal of the deposit note is convertible at any time into 40 First Preferred Shares, Series 17 of the Bank at the option of the Trust. The Trust will exercise this conversion right in circumstances in which holders of NBC CapS – Series 1 exercise their exchange rights.

The Trust is a VIE under AcG-15. Although the Bank owns the equity and voting control of the Trust, the Bank does not consolidate the Trust because it is not the primary beneficiary. As a result, NBC CapS – Series 1 issued by the Trust are not reported on the Bank's Consolidated Balance Sheet, but the deposit note is presented in the Consolidated Balance Sheet under *Deposits*. For additional information, see Note 17 to the consolidated financial statements.

Derivative financial instruments

The Bank uses various types of derivative financial instruments to meet its clients' needs, enable it to earn revenues from its trading activities and manage its exposure to exchange, interest, and credit rate risk as well as other market risks.

All derivative financial instruments, including embedded derivative financial instruments that must be bifurcated and those used as hedging items, are accounted for at fair value on the Consolidated Balance Sheet.

Transactions in derivative financial instruments are expressed as notional amounts, which serve as points of reference. These amounts are not presented as assets or liabilities on the Consolidated Balance Sheet. They represent the set underlying principal of a derivative financial instrument and serve as a reference for determining the amount of cash flows to be exchanged.

Notes 1 and 29 to the consolidated financial statements provide additional information on the types of derivatives used by the Bank and their accounting basis.

Guarantees

In the normal course of business, the Bank enters into guarantee agreements that satisfy the definition in CICA Accounting Guideline No. 14 *Disclosure of Guarantees* (AcG-14). The principal types of guarantees are letters of guarantee, backstop liquidity and credit enhancement facilities under asset-backed commercial paper conduit programs further to securitization transactions, certain derivative financial instruments, certain securities lending activities, and certain indemnification agreements. Note 28 to the consolidated financial statements provides detailed information on these guarantees, including the amounts presented in the Consolidated Balance Sheet in relation to these activities and the maximum payments the Bank could be required to make under these commitments.

A liability is recorded to reflect the fair value of the obligation assumed at the inception of guarantees that satisfy the definition in AcG-14. No subsequent remeasurement at fair value is required, unless the financial guarantee is considered a derivative financial instrument.

Margin funding of the MAV conduits

Following the events of 2007 in the third-party ABCP market, a Pan-Canadian restructuring plan was finalized on January 21, 2009. ABCP was replaced by the restructured notes of the master asset vehicle (MAV) conduits. To support the restructuring plan, the Bank committed to contribute \$911 million to the margin funding facilities. Note 9 to the consolidated financial statements provides additional information on this topic.

Credit instruments

In the normal course of business, the Bank enters into various off-balance sheet credit commitments. The credit instruments used to meet the financing needs of its clients represent the maximum amount of additional credit that the Bank could be required to extend if the commitments were fully drawn. For additional information on these off-balance sheet credit instruments and other items, see Note 28 to the consolidated financial statements.

Financial assets received as collateral

In the normal course of business, the Bank receives financial assets as collateral as a result of transactions involving securities acquired under reverse repurchase agreements, borrowing and securities lending agreements, and derivative financial instrument transactions. For further information regarding financial assets received as collateral, please see Note 28 to the consolidated financial statements.

ADDITIONAL DISCLOSURE – FINANCIAL STABILITY BOARD

The Superintendent of Financial Institutions has asked Canadian banks to apply certain recommendations published in April 2008 in the report of the Financial Stability Board. The recommendations were issued to enhance transparency and valuation with respect to certain exposures, in particular special purpose entities, subprime and Alt-A exposures, collateralized debt obligations, residential and commercial mortgage-backed securities, and leveraged financing structures.

The Bank does not market any specific mortgage financing program to subprime or Alt-A clients. Subprime loans are generally defined as loans granted to borrowers with a higher credit risk profile than prime borrowers, and the Bank does not grant this type of loan. Alt-A loans are granted to borrowers who cannot provide standard proof of income. The Bank's Alt-A loan volume was \$360 million as at October 31, 2010 (\$220 million as at October 31, 2009).

Credit derivative positions in collateralized debt obligations are provided in the following table. The Bank does not have any significant direct position in residential and commercial mortgage-backed securities.

Credit derivative positions (notional amounts)

As at October 31

(millions of dollars)

			2010	
Credit portfolio ⁽¹⁾			Trading	
	Protection purchased	Protection sold	Protection purchased	Protection sold
Credit default swaps				
Indices and single names and other	115	45	8,551	7,959
Tranches on indices	—	—	990	1,000
Collateralized debt obligation	—	—	30	30
Total return swaps	450	—	550	808
2009				
Credit portfolio ⁽¹⁾			Trading	
	Protection purchased	Protection sold	Protection purchased	Protection sold
Credit default swaps				
Indices and single names and other	131	64	9,370	8,056
Tranches on indices	—	—	1,165	1,176
Collateralized debt obligation	—	—	32	32
Total return swaps	531	—	—	21

(1) Protection sold is solely for the purpose of reducing protection purchased.

Leveraged finance loans are defined by the Bank as loans granted to large corporate and financial sponsor-backed companies that are typically non-investment grade with much higher levels of debt relative to other companies in the same industry. Leveraged finance is commonly employed to achieve a specific objective, for example, to make an acquisition, complete a buy-out or repurchase shares. Leveraged finance risk exposure takes the form of both funded and unfunded commitments. As at October 31, 2010, total commitments for this type of loan stood at \$642 million (\$300 million as at October 31, 2009).

Details about other exposures are provided in the table concerning special purpose entities on the following page.

Special purpose entities

Special purpose entities are not operating entities; they do not generally have any employees and they can include variable interest entities (VIEs) as defined in Accounting Guideline No. 15, *Consolidation of Variable Interest Entities* (AcG-15). AcG-15 requires the consolidation of a VIE by its primary beneficiary, defined as the party that absorbs the majority of the entity's expected losses, receives the majority of the entity's expected residual returns, or both. The Bank has concluded interest rate swaps with some of these entities.

As at October 31
 (millions of dollars)

		2010			2009		
		Bank's exposure		Total special purpose entity assets	Bank's exposure		Total special purpose entity assets
		Investments and other assets	Undrawn liquidity, margin funding facilities and other		Investments and other assets	Undrawn liquidity, margin funding facilities and other	
Notes							
NON-CONSOLIDATED SPECIAL PURPOSE ENTITIES							
VIEs in which the Bank has a significant variable interest							
Securitization entity for the Bank's credit card receivables (qualifying special purpose entity)	1	102	N/A	1,615	59	N/A	1,668
Multi-seller asset-backed commercial paper conduit administered by the Bank	2	5	1,143	1,152	40	449	494
Restructured notes of the MAV conduits	3	1,200	911	–	1,225	911	–
NBC Capital Trust	4	2	N/A	224	2	N/A	207
Private capital funds and investments	5	136	N/A	1,531	145	N/A	1,634
		1,445		4,522	1,471		4,003
CONSOLIDATED SPECIAL PURPOSE ENTITIES							
VIEs							
National Bank hedge fund managed accounts (Innocap platform)	7	836	N/A	1,061	923	N/A	1,260
Mutual funds	8	445	N/A	647	320	N/A	413
Building	9	86	N/A	86	89	N/A	89
Private investments	10	3	N/A	24	14	N/A	33
Other							
NBC Asset Trust	11	300	N/A	1,067	300	N/A	1,071
		1,670		2,885	1,646		2,866
		3,115		7,407	3,117		6,869

N/A – Not applicable

- (1) The Bank's exposure represents the retained rights relating to future excess spread as well as certain securities issued by the entity and acquired by the Bank.
- (2) The main underlying assets are residential and commercial mortgages, car leases, car loans and other receivables. The underlying assets are located in Canada. As at October 31, 2010, the notional committed amount of the global-style liquidity facility totalled \$1,148 million (\$489 million as at October 31, 2009), representing the total amount of commercial paper outstanding. The Bank also provides a series-wide credit enhancement facility that is limited to certain asset classes for a notional committed amount of \$30 million (\$30 million as at October 31, 2009). The maximum exposure to loss cannot exceed the amount of commercial paper outstanding. As at October 31, 2010, the Bank held \$5 million of commercial paper (\$40 million as at October 31, 2009) and, consequently, the maximum potential amount of future payments as at October 31, 2010 was limited to \$1,143 million (\$449 million as at October 31, 2009).
- (3) See the *Master Asset Vehicles* section on pages 45 to 47 of Management's Discussion and Analysis. The total amount outstanding of restructured notes of the MAV conduits totalled \$29 billion as at October 31, 2010 (\$34 billion as at October 31, 2009).
- (4) See Note 17 to the consolidated financial statements.
- (5) The underlying assets are private investments. The disclosed amount of total assets of the special purpose entities is the amount for the most recent available period.
- (6) For the consolidated special purpose entities, the Bank's exposure is net of non-controlling interests.
- (7) The underlying assets are various financial instruments (trading portfolio). The total assets of the Innocap platform are presented on a net asset basis.
- (8) The underlying assets are various financial instruments and are presented on a net asset basis. Certain mutual funds are in a trading portfolio.
- (9) The underlying asset is a building located in Canada.
- (10) The investments are presented on an equity basis.
- (11) See Note 21 to the consolidated financial statements. The average maturity of the underlying assets is three years.

CRITICAL ACCOUNTING ESTIMATES

A summary of the significant accounting policies used by the Bank is presented in Note 1 to the consolidated financial statements of this Annual Report. Certain of these accounting policies are considered critical because they are important to the presentation of the Bank's financial condition and operating results and require difficult, subjective and complex judgments and estimates because they relate to matters that are inherently uncertain. Any change in these judgments and estimates could have a material impact on the consolidated financial statements of the Bank. The Bank's critical accounting estimates are as follows.

Allowance for credit losses

The allowance for credit losses reflects management's best estimate of losses in its credit portfolio as at the balance sheet date. This allowance relates primarily to loans but may also cover the credit risk associated with deposits with financial institutions, derivative financial instruments, loan substitute securities and other credit instruments such as acceptances, commitments to extend credit, letters of guarantee and letters of credit. Management reviews portfolio credit quality on an ongoing basis to ensure that the amount of the allowance for credit losses is adequate. In assessing the adequacy of the amount of the allowance for credit losses, management must use its judgment in establishing reasonable assumptions and subjective and critical estimates concerning the probability of default, probable losses in the event of default, the amount at risk in the event of default, the amount and dates of future cash flows, the value of the underlying collateral and realization costs. Any changes in these estimates and assumptions, as well as the use of different, but equally reasonable, estimates and assumptions, could have an impact on the allowance for credit losses and, consequently, on the provision for credit losses for the year.

A detailed description of the methods used to calculate the allowance for credit losses can be found in Note 1 to the consolidated financial statements.

All operating segments, except Wealth Management, are affected by this accounting estimate.

Fair value of financial instruments

When they are initially recognized, all financial assets and liabilities, including derivative financial instruments, are recorded at fair value in the Consolidated Balance Sheet. In subsequent periods, they are measured at fair value, except for certain available-for-sale equity securities not quoted in an active market, which are recorded at cost, and items that are classified in the following categories and recorded at cost or amortized cost calculated using the effective interest rate method: financial assets held to maturity, loans and receivables, and financial liabilities not held for trading.

When a financial instrument is initially recognized, its fair value is the amount of consideration for which the financial instrument would be exchanged in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

All financial instruments recorded at fair value in the Consolidated Balance Sheet are classified using a fair value hierarchy that consists of three levels:

- Level 1 – valuation based on quoted prices (unadjusted) observed in active markets for identical assets or liabilities;
- Level 2 – valuation techniques based on inputs that are quoted prices of similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; inputs other than quoted prices used in a valuation model that are observable for that instrument; and inputs that are derived principally from or corroborated by observable market inputs by correlation or other means; and
- Level 3 – valuation techniques with significant unobservable market inputs.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, i.e., the fair value of the consideration received or paid. In certain circumstances, the initial fair value may be based on other observable current market transactions for the same instrument, without modification or repackaging, or based on a valuation technique whose variables include only observable market inputs. When the Bank uses a valuation technique based on observable market inputs to determine the initial fair value, or when the risks associated with the derivative contract are fully offset by other contracts entered into with third parties, the difference between the transaction price and the initial estimated fair value is recognized in the Consolidated Statement of Income. When the Bank uses a valuation technique based on significant unobservable market inputs, the difference between the fair value of the consideration received or paid and the amount determined using the valuation technique is deferred in the Consolidated Balance Sheet. The amount of the deferred gain or loss is recognized over the term of the financial instrument using the effective interest rate method. The unamortized balance is immediately recognized in net income when (i) observable market inputs can be obtained and support the fair value of the transaction, (ii) the risks associated with the initial contract are substantially offset by other contracts entered into with third parties, (iii) the gain or loss is realized through a cash receipt or payment, or (iv) the transaction matures or is cancelled before maturity.

When financial instruments are to be subsequently remeasured, quoted market prices in an active market provide the best indication of fair value, and when such prices are available, the Bank uses them to measure the financial instruments. A financial instrument is considered to be quoted in an active market when quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency and those prices reflect actual market transactions on an arm's length basis. The fair value of a financial asset traded in an active market generally reflects the bid price and, that of a financial liability traded in an active market, the ask price. If the market for a financial instrument is not active, the Bank establishes fair value using a valuation technique that primarily makes use of observable market inputs. Such valuation techniques include using available information concerning recent market transactions, reference to the current fair value of a comparable financial instrument, discounted cash flow analysis, option pricing models, and all other valuation techniques commonly used by market participants where it has been demonstrated that the technique provides reliable estimates.

In cases where the fair value is established using valuation models, the Bank makes assumptions about the amount, the timing of estimated future cash flows and the discount rates used. These assumptions are based primarily on observable market inputs such as interest rate yield curves, foreign exchange rates, credit curves as well as price and rate volatility factors. When one or more significant inputs are not observable in the markets, fair value is established primarily on the basis of internal estimates and data, taking into account the valuation policies in effect at the Bank, the economic environment, the specific characteristics of the financial asset or liability and other relevant factors. In certain specific cases, the Bank makes adjustments to the fair value to reflect the uncertainties in determining the fair value of financial instruments. These adjustments may stem from various factors such as the choice of valuation technique, the availability of observable market inputs, or assumptions used in the valuation techniques. The Bank may take market liquidity risk into account in determining the fair value of financial instruments not quoted in an active market when it believes that such instruments could be disposed of for a consideration below the fair value otherwise determined, due to a lack of market liquidity or an insufficient volume of transactions in a given market.

As judgment is used in applying a large number of acceptable valuation techniques and estimates to calculate fair value, fair values are not necessarily comparable among different financial institutions. The estimated fair value reflects market conditions on a given date and, consequently, may not be indicative of future fair value. Additional information on the determination of fair value is presented in Notes 4, 9, 11 and 18 to the consolidated financial statements.

Establishing fair value is a critical accounting estimate and has an impact on *Held-for-trading securities*, *Available-for-sale securities* other than available-for-sale equity securities that are not traded in an active market and are therefore presented at cost, *Obligations related to securities sold short*, *Financial instruments designated as held-for-trading*, and *Fair value of derivative financial instruments* in the Consolidated Balance Sheet. This estimate also has an impact on *Interest income* and *Other income* in the Consolidated Statement of Income of the Financial Markets segment. Furthermore, this estimate also has an impact on *Other comprehensive income* in the Consolidated Statement of Comprehensive Income.

Other-than-temporary impairment of available-for-sale securities

Available-for-sale securities are reviewed periodically to determine whether there is objective evidence of impairment. Determining whether or not there is objective evidence of impairment requires judgment and estimates. Management examines the fair value of available-for-sale securities on an ongoing basis in order to determine whether there has been an other-than-temporary decline in fair value. The examination involves analyzing the facts specific to each investment and assessing expected future returns. Impairment losses recognized in income relating to an available-for-sale debt security must be reversed in income when, in a subsequent period, the fair value of the security increases, and the increase can be objectively associated with an event occurring after the loss was recognized.

As part of this exercise, management assesses a variety of factors that could be indicative of other-than-temporary impairment. When determining whether there is objective evidence of impairment, the Bank considers the following factors: the significance of the decline in value below its cost or amortized cost, the duration of the decline in value, the financial condition and prospects of the issuer as well as the Bank's ability and intent to hold the investment until it recovers its fair value.

Any change in the evaluation of one or more of these factors used to identify *Available-for-sale securities* that have experienced an other-than-temporary decline in value resulting from objective evidence of impairment and the estimate of fair value could have an impact on the amount of losses that are recognized.

This critical accounting estimate has an impact on *Available-for-sale securities* in the Consolidated Balance Sheet as well as on *Other comprehensive income* in the Consolidated Statement of Comprehensive Income and *Other income* in the Consolidated Statement of Income for all business segments.

Securitization

Securitization is a process by which the Bank sells receivables to a trust, which funds the purchase by issuing term bonds or commercial paper to investors.

Securitization transactions are accounted for as sales when the Bank is deemed to have surrendered control over the sold assets and receives consideration other than beneficial interests in the sold assets. Additional details on the Bank's securitization transactions can be found in Notes 1 and 11 to the consolidated financial statements and in the *Variable Interest Entities* section of this Annual Report.

To calculate the gain or loss on securitization transactions, the previous carrying value of the receivables is allocated between the assets sold and the retained interests based on their relative fair value on the date of transfer. Since quoted market prices are not available for retained interests, the Bank estimates the initial and future fair value using primarily the present value of estimated cash flows. The Bank must therefore use estimates and assumptions concerning, in particular, the weighted average term, expected credit losses, prepayment rates, discount rates commensurate with the risks involved and anticipated excess spread (net of expected credit losses). The use of different estimates and assumptions could have a significant impact on income. Note 11 to the consolidated financial statements presents an analysis of the sensitivity of the current fair value of the retained interests to immediate 10% and 20% adverse changes in key assumptions. The balance of retained interests for securitized insured mortgage loans and that of securitized credit card receivables were \$360 million and \$40 million, respectively, as at October 31, 2010.

This accounting estimate has an impact on *Available-for-sale securities* in the Consolidated Balance Sheet, *Securitization revenues* in the Consolidated Statement of Income and *Other income* under *Other* in the segment results.

Goodwill, intangible assets and long-lived assets

Under Canadian GAAP, goodwill and intangible assets with indefinite lives are tested periodically for impairment to ensure that their fair value remains greater than or equal to their carrying value. The fair value of goodwill and intangible assets with indefinite lives is obtained using valuation models that take into account various factors, such as projected future cash flows and discount rates. The use of different estimates and assumptions in applying the impairment tests for goodwill and intangible assets with indefinite lives could have a notable impact on income. Note 15 to the consolidated financial statements provides additional information on this topic.

Premises and equipment and intangible assets with determinable useful lives are tested for impairment when events or changes in circumstances indicate that their carrying value may not be recoverable in the long term. An impairment loss is recorded in the Consolidated Statement of Income if the expected future undiscounted cash flows from the use of these assets and their eventual disposal are lower than their carrying value.

Goodwill, Intangible assets and Premises and equipment in the Consolidated Balance Sheet are affected by this accounting estimate.

The aggregate impairment loss, if any, is recognized as an operating expense for the corresponding segment and presented under the *Other* item.

Pension plans and other employee future benefits

The Bank's pension and other employee future benefit obligation as well as the related costs are based on actuarial valuations and management's assumptions. The key assumptions used to calculate these amounts include the discount rates for pension benefit and other employee future benefit obligations, the expected long-term rate of return on plan assets, the rate of compensation increase, mortality rates, the rate of employee turnover and changes in the cost of healthcare benefits. The use of different assumptions could have a material impact on the prepaid pension benefit cost (accrued benefit expense) presented in *Other assets (Other liabilities)* in the Consolidated Balance Sheet and on pension plan and other employee future benefit expenses presented in *Salaries and staff benefits* in the Consolidated Statement of Income. All segments are affected by this accounting estimate.

Additional information, including the significant actuarial assumptions used to determine the Bank's pension and other employee future benefit expense and the sensitivity analysis for key assumptions, can be found in Note 23 to the consolidated financial statements.

Income taxes

The Bank formulates assumptions to estimate the income tax expense as well as future income tax assets and liabilities. This process includes estimating the actual amount of income taxes payable and evaluating tax loss carry forwards and temporary differences as a result of differences between the values of the items reported for accounting and for income tax purposes. Future income tax assets and liabilities, presented in *Other assets* and *Other liabilities* in the Consolidated Balance Sheet, are calculated according to the tax rates to be applied in future periods. Previously recorded future income tax assets and liabilities must be adjusted when the expected date of the future event is revised based on current information. The Bank periodically evaluates future income tax assets to assess recoverability. In the Bank's opinion, based on current information, it is more likely than not that all future income tax assets will be realized prior to their expiration.

This accounting estimate affects *Income taxes* in the Consolidated Statement of Income for all business segments. Further information on income taxes may be found in Notes 1 and 26 to the consolidated financial statements.

Litigation

In the normal course of their business, the Bank and its subsidiaries are involved in various claims, including, in particular, court proceedings, investigations or claims of a regulatory nature, class actions or other legal remedies of varied natures. Several of the court proceedings are related to lending activities, which occur, in particular, when the Bank takes steps to recover its claims.

The Bank is also more specifically involved as a defendant in class actions instituted by consumers who contest, inter alia, certain transaction fees and the unsolicited increase of credit card limits or who wish to avail themselves of certain provincial legislative provisions relating to consumer protection. All of these involve several complex issues and their resolution could thus extend over several years. These class actions are defended vigorously by the Bank, which has serious grounds of contestation.

Even though it is impossible to determine the outcome of the claims instituted or which may be instituted against the Bank and its subsidiaries, the Bank considers that, according to the information at its disposal, while the amount of contingent liabilities pertaining thereto, taken individually or in the aggregate, could have an impact on its operating income for a particular year, it would not have a material adverse impact on the Bank's consolidated financial position.

Variable interest entities (VIEs)

In the normal course of business, the Bank enters into arrangements with VIEs. Further details are provided in the *Off-Balance Sheet Arrangements* section of this Annual Report on pages 48 to 50 and in Note 13 to the consolidated financial statements. Management is required to exercise its judgment when determining whether the VIEs should be consolidated. This process involves understanding the arrangements, determining whether the entity is considered a VIE under the accounting rules and determining the Bank's variable interests in the VIE. These interests are then compared to those of unrelated outside parties in order to identify the party that must absorb the majority of the VIE's expected losses, receive the majority of the expected residual returns of the VIE, or both, to determine whether the Bank should consolidate the entity.

FUTURE ACCOUNTING POLICY CHANGES

Conversion to International Financial Reporting Standards (IFRS)

In February 2008, the Canadian Accounting Standards Board confirmed that all publicly accountable enterprises would be required to report under IFRS for fiscal years beginning on or after January 1, 2011. The Bank will apply IFRS commencing November 1, 2011. It will present its consolidated financial statements for the quarter ending January 31, 2012 in accordance with IFRS and will present comparative figures in accordance with IFRS for fiscal 2011, including an opening consolidated balance sheet as at November 1, 2010.

To prepare for the transition to IFRS, the Bank has established an enterprise-wide project, formed a dedicated project team and put in place a formal governance structure. It has developed a detailed project plan, assessed the resource requirements for its implementation, and continued training staff, senior management, and Board members. To date, the project is proceeding according to plan, and operationalization of the IFRS transition has begun.

Project status

Governance and creation of teams

Several committees have been created to ensure project success and to optimize decision-making regarding the choices to be made for the IFRS transition. The project team consists of qualified resources, and additional professional accountants have joined the existing Accounting Policies team to absorb the workload created by this major change in accounting framework. Agreements have also been signed with external consultants and suppliers.

Execution framework and monitoring

The project follows the execution framework of the Bank's Project Office and Strategic Initiatives Office. It has been agreed that, given the complexity and scope of the IFRS project, it should be managed as a program in order to ensure more effective follow-up and a constant delivery cycle.

The project team provides regular status reports to the Executive Committee and to the Steering Committee, which are made up of senior levels of management from all relevant departments. Reports are also submitted to the Audit and Risk Management Committee and to the Bank's Board of Directors. The team also regularly presents status reports to the Office of the Superintendent of Financial Institutions (Canada) (OSFI) and to the Bank's external auditors.

Technical knowledge of IFRS

The main differences between current IFRS standards and Canadian GAAP have been identified. The Accounting Policies team has completed a detailed analysis of the IFRS standards likely to impact the Bank's consolidated financial statements and has consulted several sources of documentation to further refine their understanding of IFRS standards. The team's experts have participated in numerous conference calls, training sessions and webinars and continue to work with the external consultants to share their understanding and interpretation of the standards. Efforts have been made to identify situations that are specific to the Bank and the IFRS impacts. This period has facilitated the transfer of knowledge from the accounting policy experts to the financial accounting leaders, business specialists, the process leaders, and various information technology resources.

Training sessions with staff from the Financial Accounting and Finance groups are held on an ongoing basis. Other training sessions were offered to Credit and Risk Management personnel and to account managers to help them better understand how the transition to IFRS would affect the Bank's assessment models and credit approval processes. Various information and education sessions have also been presented to senior management, the Board of Directors and the Audit and Risk Management Committee.

Communication

The creation of several committees for project governance purposes has ensured that information is constantly communicated to all management levels of the groups affected by the project, and the workshops held to examine IFRS impacts have served as a means of disseminating information to the parties affected by the transition. The creation of an IFRS intranet has enabled the business-wide dissemination of information, and a comprehensive strategy for communication with investors is currently being developed.

Technology developments

The technological developments needed for the transition to IFRS have largely been identified, and no significant change is necessary. The adjustments that are required relate to the need to produce financial data for the 2011 fiscal year in accordance with Canadian GAAP for reporting purposes while also producing the data under IFRS standards for comparison purposes upon publication of the fiscal 2012 results. Both main technological developments required for this dual-accounting period and the acceptance test period have been completed.

Accounting implementation

The planning for the accounting implementation phase is complete. A preliminary version of model IFRS financial statements and the notes thereto was submitted to the project Steering Committee during the fourth quarter of 2010. The processes and tools needed to prepare the Bank's opening consolidated statement of financial position on an IFRS basis have been developed and approved by the governance team overseeing the implementation project. The processes for the dual-accounting period are in place, and testing has been completed. The team dedicated to this implementation is working on action plans to ensure the integrity of internal controls during the transition.

The Bank's Financial Governance and Internal Audit departments will guide the project team through the above-described activities. The Bank's internal controls over financial reporting are reviewed on an ongoing basis.

Business activities

Some of the Bank's clients will be transitioning to IFRS, which could have an impact on the restrictive covenants in loan agreements. The legal clause applicable to the financial statements provided by clients has been revised to take the impacts of IFRS into account, and it has been approved and sent to all parties involved. This new clause has now been incorporated into the credit agreements of all new clients, new loans, refinancings, and loan renewals.

As for other potential consequences, the Bank is gradually listing the impacts of the IFRS transition, takes them into consideration in managing regulatory capital, and will factor them into forecasting processes.

First-time adoption of IFRS

Adoption of IFRS will require the Bank to follow the recommendations of IFRS 1, *First-time Adoption of International Financial Reporting Standards* (IFRS 1). IFRS 1 generally prescribes that entities must retrospectively apply all IFRS standards upon transition, which, for the Bank, is November 1, 2010. When a standard is applied retrospectively, the opening consolidated balance sheet will be presented as though IFRS had always been applied, and the differences between Canadian GAAP and IFRS will be reflected in the IFRS opening retained earnings. However, IFRS 1 also provides mandatory exceptions to the retrospective application of certain IFRS standards and permits optional exemptions to this requirement for other IFRS standards. For the Bank, the main optional exemptions relate to (i) employee benefits, (ii) financial instrument designation, (iii) translation differences and (iv) business combinations. Applying certain exemptions will also affect the opening retained earnings under IFRS and could impact the results of post-IFRS-transition periods. A summary of the main optional exemptions is presented below.

Employee benefits

With respect to the actuarial gains and losses related to employee benefits, the Bank will have two options when it implements IFRS: either to recognize all unamortized gains and losses as at November 1, 2010 in retained earnings, or to calculate the charge from the time the Bank's plans were implemented as if the charge had always been calculated under the IFRS requirements on employee benefits. The Bank is planning to apply the first option.

Financial instrument designation

IFRS 1 offers an option whereby entities may, at the transition date, irrevocably designate any financial instrument as held-for-trading provided that certain criteria are met on that date. The Bank intends to use this option.

Translation differences

Under IFRS 1, cumulative currency translation differences can be reclassified to retained earnings. The Bank is planning to apply this optional exemption.

Business combinations

IFRS 1 permits prospective application of the standard on business combinations. The Bank is planning to apply this optional exemption so as to not restate business acquisitions completed before the transition date.

The Bank is still in the process of analyzing most of the IFRS 1 exemptions and has not made final decisions on all of the exemptions. In March 2010, OSFI issued an advisory entitled *Conversion to International Financial Reporting Standards (IFRSs) by Federally Regulated Entities (FREs)*. OSFI is providing banks with the possibility to phase in, over five quarters, most of the negative impacts that conversion to IFRS will have on retained earnings for the purposes of calculating regulatory capital.

Main differences between Canadian GAAP and IFRS

The Bank has already identified the major differences between current Canadian GAAP and IFRS that will require adjustments to the opening balance sheet and retained earnings upon transition. The current standards likely to have a significant impact on the Bank's consolidated financial statements include the standards on (i) financial instrument derecognition, (ii) consolidation, (iii) employee benefits, (iv) impairment of available-for-sale securities, and (v) business combinations. A summary of the main differences is presented below.

Financial instrument derecognition

The current criteria for financial asset derecognition under IFRS differ significantly from those under Canadian GAAP. Currently, under Canadian GAAP, the Bank derecognizes financial assets using a model based on control and legal form. Under IFRS, derecognition is subject to more restrictive criteria, which are largely based on the notion of the transfer of substantially all of the risks and rewards related to ownership of the transferred assets. The Bank will retrospectively apply the derecognition requirements and expects that several financial asset transfers eligible for derecognition under Canadian GAAP will no longer qualify under IFRS. For instance, the Bank does not expect insured mortgage loans securitized under the Canada Mortgage Bond (CMB) Program to qualify for derecognition under IFRS. These mortgage loans will therefore be presented in the opening IFRS consolidated balance sheet as at November 1, 2010, thereby increasing total assets and liabilities. Also, because these are financing transactions, the Bank will no longer realize a securitization gain on the sale of mortgage loans under the CMB Program. On the transition date, November 1, 2010, the opening balance of retained earnings under IFRS will reflect the impact of recognizing past transactions as financing transactions instead of sale transactions. Also, in its notice published last March, OSFI stated that insured mortgage loans securitized before March 31, 2010 under the CMB Program will have no impact on the financial leverage ratio.

Consolidation

Canadian GAAP requires the consolidation of a variable interest entity (VIE) by its primary beneficiary, namely, the party that absorbs the majority of the entity's expected losses, receives the majority of the entity's expected residual returns, or both. Furthermore, Canadian GAAP provides an exemption for the consolidation of qualifying special purpose entities, eligible under certain conditions, that does not exist in IFRS. Under IFRS, the consolidation of special purpose entities is required, based on the application of the principle of control. The Bank may need to consolidate new special purpose entities that were not consolidated prior to the Bank's IFRS transition date. Consolidation of these new entities could increase the assets and liabilities as well as non-controlling interests on the Bank's Consolidated Balance Sheet.

Employee benefits

The Bank offers defined benefit pension plans that cover substantially all salaried employees. Under Canadian GAAP, past service cost is amortized over the average remaining service life of employees, whereas under IFRS standards, the vested past service cost is recognized immediately in the Statement of Income. Following the transition, the Bank will need to choose either to recognize the actuarial gains and losses immediately in the Consolidated Statement of Income or the Consolidated Statement of Comprehensive Income or to continue to amortize actuarial gains and losses using the corridor approach (the method currently used under Canadian GAAP).

Impairment – Available-for-sale securities

Under IFRS, a decline in value is recognized in the Statement of Income when there is objective evidence of impairment. Under Canadian GAAP, an entity must also determine whether there is objective evidence of impairment, but unlike IFRS, impairment is recognized only if it is considered other than temporary. Impairment will be recognized more quickly under IFRS.

CAPITAL MANAGEMENT

Business combinations

There are several differences between IFRS and Canadian GAAP related to the accounting for business combinations. The main items impacted include acquisition costs and restructuring costs, non-controlling interest, contingent consideration, and valuation of consideration paid in shares. Under Canadian GAAP, acquisition costs and certain restructuring costs are capitalized in goodwill, whereas under IFRS, they are expensed as incurred. For business combinations under Canadian GAAP, non-controlling interest is calculated based on the carrying value of the acquired company, and any contingent consideration is recognized only under certain circumstances, whereas under IFRS, these two items are measured at fair value at the time of the business combination. Under Canadian GAAP, shares issued as consideration are measured at their market price over a reasonable period of time (i.e., a few days) before and after the date the acquisition is announced, whereas under IFRS, the issued shares are measured at their market price on the acquisition date. These differences will have an impact on the purchase price allocation and on the amount of goodwill recognized in the Consolidated Balance Sheet.

Latest IFRS and regulatory developments

The International Accounting Standards Board (IASB) continues to propose changes to IFRS. In fiscal 2010, the IASB published a new standard on the classification and measurement of financial assets and financial liabilities, but these changes will not have to be adopted until after the transition date. In addition, other key standards affecting financial instruments will likely be amended, in particular the impairment of financial assets, hedge accounting, and the offsetting of assets and liabilities. Other major standards are also being revised, including those applicable to employee benefits, consolidation, income taxes and financial statement presentation. The Bank will probably not be required to apply these changes until after the transition date. The Bank is closely monitoring the changes made to these standards and to OSFI regulations and will make any required adjustments to its plan.

The standards in effect at the transition date, the economic environment at that time, the consolidated balance sheet amounts at that time, and the various accounting policy choices yet to be selected are some of the factors that will influence the impact of IFRS on the Bank. In the periods preceding the first fiscal year in which IFRS will be adopted, the impacts of transitioning to IFRS on the Bank's consolidated financial statements will be disclosed as they become known.

Capital management framework

Capital management consists in maintaining the capital required to cover risks, complying with the regulatory capital ratios defined by the Office of the Superintendent of Financial Institutions (Canada) (the Superintendent) and assessing the economic capital required for the Bank's operations. The Bank uses both regulatory and economic capital to evaluate the performance of its business units and to make strategic, tactical and transaction decisions while ensuring a competitive return on shareholders' equity. The Bank's capital management policies set out the principles and practices the Bank incorporates into its capital management strategy and the basic criteria it adopts to ensure that it has sufficient capital at all times and that it is prudently managing such capital in view of its future capital requirements. A capital plan sets operational targets and takes into account expected levels for risk-weighted assets, determined under the regulatory approach. Moreover, this capital plan presents the different strategies that are available to the Bank to optimize capital management, including the issuance and repurchase of equity securities and subordinated indebtedness and the dividend policy.

Structure and governance

The Board oversees the structure and development of the Bank's capital management policies and ensures that it maintains sufficient capital in accordance with regulatory requirements and in consideration of market conditions. The Board delegates certain responsibilities to the ARMC, which then recommends capital management policies and oversees their application. Accordingly, the Board, on the recommendation of the ARMC:

- reviews and approves the capital management policy;
- reviews and approves the Bank's risk tolerance, including the main capital and risk targets and the corresponding limits;
- reviews and approves the capital plan and strategy on an annual basis, including the Bank's internal capital adequacy assessment process;
- reviews and approves the implementation of significant measures respecting capital, including contingency measures; and
- reviews significant capital-related disclosures, including Basel II capital adequacy reporting.

The Office of the President is responsible for defining the Bank's strategy and plays a key role in guiding measures and decisions regarding capital.

The Asset/Liability Management Committee oversees capital management under the delegated authority of the Global Risk Management Committee of the Office of the President. The Asset/Liability Management Committee is chaired by the Chief Financial Officer and Executive Vice-President of Finance, Risk and Treasury and comprises the officers from these teams as well as the individuals in charge of each business unit. The role of this committee includes reviewing and making recommendations concerning the capital management policy, the capital plan and strategy, and the implementation of all significant measures respecting capital, including contingency measures, and making recommendations with respect to these measures.

Basel II Accord

The standards for calculating and disclosing capital in accordance with the Basel II Accord took effect in Canada on November 1, 2007. In 2009, to comply with certain disclosure requirements, additional information has been added to the MD&A in the *Additional Financial Information* section and in the *Supplementary Financial Information* available on the Bank's website at www.nbc.ca. Information concerning other disclosure requirements is presented in Notes 5 and 6 to the consolidated financial statements. The rules should allow for greater uniformity in terms of capital requirements in the international banking industry while providing for enhanced sensitivity of capital to risks. They also require an explicit capital charge to cover operational risk and require more detailed reporting of risk management.

The Basel II Accord proposes a range of approaches of varying complexity, the choice of which determines, to a greater or lesser extent, the sensitivity of capital to risks. A less complex approach, such as the Standardized Approach, will use regulatory weightings, while a more complex approach will use the Bank's internal estimates of risk components to establish risk-weighted assets and calculate regulatory capital.

The Bank has complied with the Basel II regulatory framework since November 1, 2007. On November 1, 2009, the Bank received approval from the Superintendent to use the Basel II Advanced Internal Rating-Based (AIRB) approach to calculate credit risk capital for consolidated regulatory reporting purposes. The Bank is using the Standardized Approach for operational risk. With respect to market risk, the Bank continues to use the models and the Standardized Approach in accordance with the Basel II Accord.

The Bank's capital management process was already largely compliant with the principles of the Basel II Accord, but nevertheless it implemented a rigorous internal capital adequacy assessment process. Assessing capital adequacy is an integral part of capital planning and the capital strategy. Capital Management is, with its partners from Risk Management, Treasury and Finance, responsible for maintaining integrated controls and control processes so that an overall assessment of capital adequacy may be performed. The capital adequacy assessment consists of:

- conducting an overall risk assessment;
- measuring significant risks and the capital requirements on the Bank's financial budget for the next fiscal year and current and prospective risk profiles;
- integrating stress testing across the organization and a sensitivity analysis to determine a margin of capital above minimum regulatory levels;
- aggregating capital and monitoring the reasonableness of internal capital compared with regulatory capital;
- comparing projected internal capital with regulatory capital levels, internal operating targets, and competing banks; and
- providing attestation of the adequacy of the levels of capital at the Bank.

The Bank's internal capital adequacy assessment process demonstrates that it has a solid financial structure and sufficient capital to meet management's assessment of capital requirements under both normal market conditions and a range of severe but plausible stress testing scenarios. This process is a key tool in establishing the Bank's capital strategy and is subject to a quarterly review and periodic amendments.

Strengthening the resilience of the banking sector

On September 12, 2010, the Group of Central Bank Governors and Heads of Supervision (the "Basel Committee") published its "calibrated" capital standards, which form part of its proposed reforms to bank capital adequacy requirements, often referred to as "Basel III." Under these standards, when fully phased in on January 1, 2019, banks will be required to maintain:

- a Core Tier 1 ratio of at least 7%, 4.5% attributable to a minimum Tier 1 common equity ratio and 2.5% attributable to a capital conservation buffer;
- a Tier 1 capital ratio of at least 8.5%, 6% attributable to a minimum Tier 1 capital ratio and 2.5% attributable to a capital conservation buffer; and
- a total capital ratio of at least 10.5%, 8% attributable to a minimum Total capital ratio and 2.5% attributable to a capital conservation buffer.

The Basel Committee also announced that a "countercyclical buffer" of between 0% to 2.5% on common equity or other fully loss-absorbing capital will be required according to national circumstance.

The proposed reforms represent a major change to the standards set out in the Basel II Accord (2004) and will include major changes to capital ratio calculations. The proposal also includes a new mandatory leverage ratio, which differs dramatically from the current assets to capital multiplier. The Bank is in a good position to face these new requirements over the transition period, owing to its strong capital position combined with its internally generated capital.

Capital management in 2010

Management activities

During fiscal 2010, the Bank did not issue or repurchase any shares and consistently maintained an appropriate capital structure.

Dividend

At \$2.48 per share, the dividend on common shares remained the same as that of 2009. The dividend payout ratio of 39% in 2010 and 40% in 2009, excluding specified items, is slightly below the Bank's target payout range of 40% to 50%.

Capital

The Bank ensures that capital levels at all times exceed the minimum capital requirements established by the guidelines of the Superintendent according to the standards of the Bank for International Settlements (BIS). The top corporate entity to which the Basel II rules apply at the consolidated level is National Bank. Investments in non-consolidated entities are deducted from regulatory capital, and the assets of those entities are excluded from aggregate Risk-Weighted Assets (RWA).

The definition adopted by BIS distinguishes between three types of capital. Tier 1 capital consists of common shareholders' equity and non-cumulative preferred shares, the eligible amount of innovative instruments and non-controlling interests, less goodwill. Tier 2 capital consists of preferred shares not eligible for Tier 1 capital, the eligible portion of subordinated debentures, the eligible general allowance for credit risk as well as the eligible amount of innovative instruments that could not be included in Tier 1 capital. A third tier of capital is intended specifically to cover market risk, which is also covered by Tier 1 capital. "Total regulatory capital" is the sum of all capital net of investments in companies subject to significant influence and first-loss protection with respect to asset securitization.

Under the requirements of the Basel II Accord standards framework, the capital of insurance companies held by the Bank and investments in entities over which the Bank exercises significant influence are deducted in equal parts from Tier 1 capital and Tier 2 capital. However, on an interim basis, the Superintendent is allowing the entirety of these amounts for insurance companies to be deducted from Tier 2 capital for all investments made before January 1, 2007. This transitional period ends on October 31, 2011.

Risk-weighted assets

As required under Basel II, Risk-Weighted Assets (RWA) are calculated for each credit risk, market risk, and operational risk. The Bank uses the Advanced Internal Rating-Based Approach for credit risk to determine minimum regulatory capital requirements for a majority of its portfolio. Certain portfolios considered non-material from a consolidated perspective are risk-weighted according to the Basel II Standardized Approach for credit risk. For operational risk, the Bank is using the Standardized Approach. Market risk-weighted assets are primarily determined using the Internal Model-Based Approach. Trading positions in foreign exchange, interest rate, equity, commodity and credit trading have capital requirements calculated using Value-at-risk (VaR). Also, the Bank uses the standardized model approaches to measure market risk capital for interest-rate-specific risk.

For externally-rated securitization exposures, the Bank uses the Rating-Based Approach (RBA). The approach assigns risk weights to exposure using external ratings. The Bank uses ratings assigned by one or more of Moody's Investors Service, Standard & Poor's, Fitch and DBRS. The RBA also takes into account additional factors, including the time horizon of the rating (long-term or short-term), the amount of detail available on the underlying asset pool and the seniority of the position. Under the RBA, exposures are multiplied by risk weights prescribed by the Superintendent to calculate the risk-weighted assets.

During the year, RWA decreased by \$8.8 billion, primarily due to implementation of the Advanced Internal Rating-Based Approach for credit risk. The Bank's risk-weighted assets are presented in the *Capital Adequacy Under Basel II* table (Table 13, page 82).

Regulatory capital ratios

The Superintendent considers financial institutions to be well-capitalized if they maintain a Tier 1 capital ratio of 7% and a total regulatory capital ratio of 10%. Capital ratios are calculated by dividing the tiers of capital described previously by risk-weighted assets. Credit, market and operational risks are considered in the calculation of risk-weighted assets for regulatory purposes.

The Tier 1 and total capital ratios under the BIS rules (Basel II) were respectively 14.0% and 17.5% as at October 31, 2010, compared to 10.7% and 14.3% as at October 31, 2009. The increase in the ratios was attributable to capital management activities and internally generated capital. In addition to regulatory capital ratios, banks are expected to meet an assets-to-capital multiple test. The assets-to-capital multiple is calculated by dividing the Bank's total assets, including specified off-balance sheet items, by its total regulatory capital. As at October 31, 2010, the multiple was 15.9.

Tangible common equity, which is not a regulatory ratio, is calculated by dividing common equity, non-controlling interests less goodwill, and other intangible assets by risk-weighted assets plus risk-weighted securitized assets. As at October 31, 2010, tangible common equity was 9.8% compared to 6.9% one year earlier.

Economic capital

Economic capital is the internal measure used by the Bank to determine its solvency and the capital required to pursue its business operations. Economic capital takes into consideration the credit, market, operational and business risks to which the Bank is exposed, in addition to the risk diversification effect between them and among its different business segments. Economic capital thus helps determine the equity capital the Bank requires to protect itself against such risks and ensure its long-term viability. The method used to assess economic capital is reviewed regularly so as to accurately quantify these risks.

Risk-adjusted return on capital (RAROC) and shareholder value added (SVA), which are obtained from the assessment of required economic capital, are calculated quarterly for each of the Bank's business segments. The results are then used to guide management in allocating capital among the different business segments.

Available capital and active capital management

As part of the active capital management process, the concepts of available capital (equity capital), regulatory capital and economic capital are emphasized in order to maximize SVA. This process leads first to the development of the capital plan and then to the allocation of capital among the different business segments in order to optimize SVA creation without unduly impacting the Bank's regulatory capital ratios.

RISK MANAGEMENT

The Bank views risk as an integral part of its development and the diversification of its activities, and advocates a risk management approach consistent with its business expansion strategy. The purpose of sound risk management is to provide reasonable assurance that incurred risks do not exceed acceptable thresholds and that risk-taking contributes to the creation of shareholder value. For the Bank, this means striking a healthy balance between return and risk.

The Bank is affected by risk in two ways. First, it exposes itself voluntarily to certain categories of risk, especially credit and market risk, in order to generate revenue. Second, it must assume the risks inherent to its activities to which it does not choose to expose itself and that do not generate revenue, i.e., operational risk. These risks may result in losses that could adversely affect expected earnings from value-creating activities.

In the normal course of business, the Bank is primarily exposed to the risks described below.

Credit risk

Risk of a financial loss if an obligor does not fully honour its contractual commitments to the Bank. Obligors may be borrowers, issuers, counterparties or guarantors.

Market risk

Risk of a financial loss resulting from unfavourable changes in underlying market factors, namely, interest rates, foreign exchange rates, equity prices, commodity prices, credit risk and market volatility.

Liquidity risk

Risk that the Bank will be unable to honour daily cash commitments without resorting to costly and untimely measures.

Operational risk

Risk of loss resulting from an inadequacy or a failure ascribable to people, processes, technology or external events.

Regulatory risk

Risk related to the consequences of failing to meet compliance obligations, i.e., when the Bank or one of its employees fails to comply with relevant legislation in effect where the Bank carries on its operations, which can lead to penalties, sanctions and heavy financial losses.

Reputational risk

Risk that the Bank's operations or practices will be judged negatively by the public, whether that judgment is with or without basis, thereby adversely affecting the perception, image or trademarks of the Bank, potentially resulting in costly litigation or loss of income.

Environmental risk

Risk of a loss or of injury to the Bank's reputation, arising from environmental concerns related to the Bank or its clients. Environmental risk is often associated with credit risk and operational risk.

Risk, in all its forms, must be rigorously managed. That means it must be identified, measured and controlled to ensure that Bank operations yield an adequate return for the level of risk assumed. In other words, the risk-return trade-off must be optimized.

Risk management requires a solid understanding of all risks Bank-wide and must provide assurance that risk levels do not exceed acceptable thresholds. Moreover, effective risk management can help control the volatility of the Bank's results.

Despite the exercise of stringent risk management, risk cannot be suppressed entirely. The residual risk may occasionally cause significant losses.

Risk management framework

To achieve its risk management objectives, the Bank has a risk management framework that comprises the following elements:

- a risk management culture
- a governance structure
- definition of overall capacity to manage risk and a risk tolerance
- independent oversight by the Corporate Compliance Department
- an independent assessment by the Internal Audit Department
- risk management policies
- a review of risk decisions by independent professionals
- allocation of capital to the business units based on the level of risk assumed by each unit

Risk management culture

The Bank and its management routinely promote a risk management culture through internal communications that advance a balanced model where business development initiatives are accompanied by a constant concern for sound risk management.

Governance structure

The governance structure at the Bank sets out the roles and responsibilities of all levels of the organization.

The Audit and Risk Management Committee of the Board (ARMC)

The ARMC approves risk management policies and sets risk tolerance limits. In addition to ensuring that the appropriate resources, policies and procedures are in place to properly and effectively manage risk on an ongoing basis, it examines and approves all significant aspects of risk assessment systems.

The Bank's Management

The Bank's Management promotes the risk management culture Bank-wide and manages the primary risks to which the Bank is exposed.

The Global Risk Committee

The Global Risk Committee defines the parameters of the policies that determine risk tolerance and the overall risk strategy, for the Bank and its subsidiaries as a whole, and sets limits as well as tolerance and intervention thresholds enabling the Bank to properly manage the main risks to which it is exposed. The Committee approves and monitors all large credit facilities. The following risk committees report to the Global Risk Committee: the Market Risk Management Committee, the Operational Risk Management Committee and the Asset/Liability Management Committee.

The Risk Management Group

This group proposes risk management policies and implements tools and models for identifying, measuring and monitoring risks. In addition to instituting and applying various independent risk review and approval procedures, this group also proposes risk limits that reflect the risk tolerance established by the ARMC and informs management and the Board of significant risks.

The business units

The business units manage risks related to their operations within established limits and in accordance with risk management policies by identifying, analyzing and understanding the risks to which they are exposed and implementing risk mitigation mechanisms.

Independent oversight by the Corporate Compliance Department

The Corporate Compliance Department is responsible for implementing a Bank-wide regulatory risk management framework by relying on an organizational structure that includes functional links to the Bank's main operating segments.

Corporate Compliance is an independent department within the Bank. Its Vice-President enjoys direct access to the Chair of the ARMC and to the President and Chief Executive Officer. Under the powers conferred on it, the Corporate Compliance team can also communicate directly with officers and directors of the Bank and its subsidiaries, obtain unrestricted access to files, reports, records and data, and require employees of the Bank and each of its group's entities to provide it with the information deemed necessary for effective oversight.

Business unit managers are responsible for implementing mechanisms for daily control of regulatory risks arising from the operations under their responsibility. Corporate Compliance exercises independent oversight to assist managers in managing these risks effectively and to obtain reasonable assurance that the Bank is compliant with regulatory requirements.

The control framework covers the following:

- identification, evaluation, communication, maintenance and updating of regulatory requirements
- identification of the business units affected by these requirements
- documentation of compliance and regulatory requirement controls applicable to daily operations, including monitoring procedures, remedial action plans and periodic reports produced by business units
- independent oversight of the application of policies and procedures in effect
- quarterly reporting to the ARMC on the main results of compliance oversight

Independent assessment by the Internal Audit Department

The Internal Audit Department is an independent function within the Bank. The Senior Vice-President of Internal Audit reports to the Chair of the ARMC. The independence of the Senior Vice-President of Internal Audit is also ensured through a direct line of communication with the President and Chief Executive Officer. Moreover, the Senior Vice-President of Internal Audit may, at any time, call an unscheduled ARMC meeting.

Internal Audit is mandated to provide the Board, through the ARMC, and the Office of the President with an independent and objective review of the Bank's internal control effectiveness, i.e., governance processes, risk management processes and control measures.

As Internal Audit is not mandated to institute internal control mechanisms but rather to assess their effectiveness, it has no direct responsibility or authority over the activities it reviews. Whenever recommendations are issued, Internal Audit is mandated to independently assess the appropriateness of measures taken by the managers to resolve the issues.

Internal Audit supports the objectives of the Bank's Board of Directors and management by recommending improvements to the effectiveness of risk management, internal controls (including controls on the reliability of financial reporting and disclosure), internal governance and operating activities. In so doing, Internal Audit helps protect the Bank's reputation as well as the interests of its shareholders, employees and clients.

Internal Audit has unrestricted jurisdiction over all of the Bank's segments and subsidiaries.

Risk management policies

Risk management policies, along with the related guidelines and procedures, are the essential elements of the risk management framework. They describe how business units must manage risk and the approval process for risk decisions and, in particular, set the risk limits to be adhered to. These policies cover all the main risks defined in the Bank's risk management approach and are reviewed on a regular basis—in most cases, annually—to ensure that they are still relevant given changes in the markets and the business plans of the Bank's many business units. Other policies, standards and procedures complement the risk management policies and cover more specific aspects of management, such as business continuity and the launch of new products, initiatives or activities. These policies, standards and procedures generally apply across the Bank.

Credit risk management

Credit risk is the most significant risk facing the Bank in the normal course of business. The Bank is exposed to credit risk not only through its direct lending activities and transactions, but also through commitments to extend credit, letters of guarantee, letters of credit, over-the-counter derivatives trading, available-for-sale debt securities, securities purchased under reverse repurchase agreements, deposits with financial institutions, brokerage activities and transactions carrying a settlement risk for the Bank such as fund transfers to third parties via electronic payment systems.

A policy framework centralizes the governance of activities that generate credit risk for the Bank as a whole and is supplemented by a series of subordinate internal or sectoral policies and guidelines used to provide more thorough coverage of the given business lines or deal with specific management issues such as credit limits, collateral requirements and risk assessment. For example, the institutional activities of the Bank and its subsidiaries on financial markets are governed by sector-specific directives that set out standards adapted to the specific environment of financial markets. This also applies to activities in the Bank's retail brokerage subsidiaries. In some cases, a business unit or subsidiary may have its own credit policy, and that policy must always fall within the spirit of the Bank's policy framework and be reviewed and approved by the management of the Credit Risk Management Group. The Credit Risk Management Group is responsible for defining the scope of the universe of subsidiaries carrying significant credit risks and the magnitude of the risks incurred.

Credit risk is controlled through a rigorous and methodical process that comprises the following elements:

- credit risk assessment
- assessment of capital at risk
- credit-granting process
- risk mitigation
- account follow-up and recovery
- identification of impaired loans and provisioning for credit losses

Credit risk assessment of loans

Before a sound and prudent credit decision can be taken, the credit risk represented by the borrower or counterparty must be accurately assessed. This assessment is performed at the outset of the credit application process. Each application is analyzed and assigned one of 19 grades on a scale of 1 to 10 using a credit rating system developed by the Bank for all portfolios exposed to credit risk. As each grade corresponds to a borrower's or counterparty's probability of default, the credit risk can be determined for the Bank. The credit risk assessment method varies according to portfolio type.

The main parameters used in measuring the credit risk of loans outstanding and undrawn amounts are as follows:

- probability of default (PD), which is the probability that the obligor in question will default within one year;
- loss given default (LGD), which represents the magnitude of the expected loss from the obligor's default, expressed as a percentage of exposure at default; and
- exposure at default (EAD), which is the estimated amount potentially drawn at the time of the obligor's default.

Personal credit portfolios

This category comprises credit portfolios composed of residential mortgage loans, consumer loans and loans to certain small businesses. The credit risk of these portfolios is measured using credit scoring models. The obligor's default risk rating for personal credit is determined using these models. The assessment also takes product risk into account, for example, lines of credit versus term loans. Personal credit risk assessments are based on a group of borrowers with similar credit histories and behaviour profiles.

The credit scoring models are used to grant credit to new clients. These tools use proven statistical methods that measure applicants' characteristics and history based on internal and external historical information to estimate the applicant's future credit behaviour and assign a default risk rating. The underlying data include client information such as current and past employment, historical loan data in the Bank's management systems and information from external sources such as credit rating agencies.

The Bank also uses behaviour scoring models to manage and monitor current commitments. The risk assessment is based on statistical analyses of the past behaviour of obligors with which the Bank has a long-term relationship, to predict their future behaviour. The underlying information includes the obligor's cash flows and borrowing trends. Information on characteristics that determine behaviour in these models also comes from both internal sources on current commitments and external sources.

A risk analysis based on loan grouping in pools of homogeneous obligor profile is used for overall management of personal credit portfolios. This personal credit assessment approach, which has proven particularly effective for estimating loan defaults and losses, takes a number of factors into account, namely:

- behaviour scoring
- loan product characteristics
- collateral provided
- the length of time on the Bank's balance sheet
- loan status (active, delinquent or defaulted)

A mechanism like this will provide adequate risk measurement in as much as it effectively differentiates risk levels by pool. Therefore, the results are reviewed periodically and lead to model adjustments if necessary. Obligor migrations between pools are among the factors considered in the credit risk assessment.

Loan pools are also established based on probability of default, loss given default and exposure at default, which are measured based on the characteristics of the obligor and the transaction itself. Loss given default is estimated based on transaction-specific factors, including loan product characteristics, loan-to-value ratio and types of collateral. Under the Bank's default and facility risk rating policies, as well as the review and renewal policy and risk quantification policy, the default risk ratings must be reviewed annually.

Business and government credit portfolios

This category comprises business (other than some small businesses, which are classified in personal credit portfolios), government and financial institution credit portfolios.

These credit portfolios are assigned a risk rating based on a detailed individual analysis of the financial and non-financial aspects of the borrower, including its financial health, sector of economic activity, competitive ability, access to capital and management quality. The Bank has risk rating tools and models enabling it to specifically assess the risk represented by an obligor in relation to its industry and peers. The models used are adapted to the obligor's broad sector of activity. Models have been set up for seven sectors: business – commercial, large business, banks-brokerage, sovereigns, energy, real estate and agriculture.

This risk assessment method assigns a default risk rating to an obligor that reflects its credit quality. For each credit risk rating corresponds a probability of default (see the table on the following page). This credit quality classification enables the Bank to adequately differentiate its respective assessments of an obligor's ability to meet its contractual obligations. This kind of assessment must be done independently of external circumstances, particularly adverse economic or financial conditions likely to put stress on the business. Default risk ratings are assigned according to an assessment of the obligors' commercial and financial risks, based on a solvency review. Various risk quantification models, described below, are used to perform this assessment.

The business and government default risk rating scale used by the Bank is similar in some ways to the systems used by major external rating agencies. The Bank's scale has 19 grades. The table below groups these grades by major risk category and compares them with the ratings of two major rating agencies.

Internal default risk ratings – Business

Ratings	Standard & Poor's	Moody's	Description ⁽¹⁾
1 – 2.5	AAA to A-	Aaa to A3	Excellent
3 – 4	BBB+ to BBB-	Baa1 to Baa3	Good
4.5 – 6	BB+ to B+	Ba1 to B1	Satisfactory
6.5 – 7.5	B to CCC+	B2 and Caa1	Special mention
8 – 8.5	CCC and CCC-	Caa2 and Caa3	Substandard
9 – 10	CC, C and D	Ca, C and D	Default

(1) Additional information is provided in the tables on page 118.

The Bank also uses individual assessment models to assign a risk rating to the credit facility based on the collateral and guarantees the obligor is able to provide and, in some cases, based on other factors.

The Bank consequently has a bi-dimensional risk rating system that, using internal and external historical data, establishes a default risk rating for each obligor, and models that assign a risk rating to the credit facility that is independent of the risk rating assigned to the obligor.

The Bank's default, and in some cases, facility risk rating systems and the associated risk parameters are used to estimate expected and unexpected losses, risk-based pricing as well as to establish counterparty credit concentration limits, assess economic capital and generally manage credit portfolios.

Validation

The effectiveness of the risk rating systems and associated parameters is monitored by the Risk Management Group and reviewed at least once a year in accordance with the Bank's policies.

Backtesting is done at regular intervals to check the effectiveness of the models used to measure probability of default, loss given default and exposure at default. For probability of default in particular, this backtesting takes the form of sequentially applied statistical tests designed to assess the following criteria:

- the model's discriminatory power
- overrides
- model calibrating
- the stability of the model's output

The credit risk quantification models are developed and tested by a specialists team and their performance is monitored by the applicable business units and related credit risk management services. New models are validated by a unit that is independent of both the specialists that developed the model and the concerned business units, and approved through an escalation process established by the Model risk management policy. Furthermore, under that Policy, new models or changes to existing models that materially impact regulatory capital must be reported to the Board of Directors once a year.

Existing credit rating systems, methods and models are also subject to periodic independent validation, as often as required by the inherent risk of the activity in question. Models that have a material impact on regulatory capital must be reviewed at least once a year, thereby further raising the certainty that these quantification mechanisms are working as expected. The key aspects to be validated are factors allowing accurate risk classification by level, adequate quantification of exposure, use of assessment techniques taking account of external factors such as economic conditions and credit status and, lastly, compliance with internal policies and regulatory provisions.

The Bank's credit risk assessment and rating systems are overseen by the ARMC and the Global Risk Committee and are an integral part of a comprehensive Bank-wide credit risk oversight framework. Along with the above-mentioned elements, policies, definition of responsibilities, resource allocation and existing processes are documented and periodically reviewed.

Assessment of capital at risk

The assessment of the Bank's capital at risk, or economic capital, is based on the credit risk assessments of various borrowers. These two activities are therefore interlinked. The different models used to assess the credit risk of a given portfolio type also enable the Bank to determine the default correlation among borrowers. This information is a critical component in the evaluation of potential losses for all portfolios carrying a credit risk. Potential losses, whether expected or not, are based on past loss experience, portfolio monitoring, market data and statistical modeling. The main risk factors are as follows:

- probability of default
- balance outstanding at the time of default
- expected loss in the event of default
- correlation between transactions
- term of credit commitments
- impact of economic and sector-based cycles on asset quality

Expected and unexpected losses are factors in the assessment of capital at risk for each sector of activity. The Bank also carries out stress tests to evaluate its sensitivity to crisis situations in certain sectors of activity and key portfolios (e.g., forestry products, manufacturing, etc.). A global stress test methodology will cover most business and government credit portfolios as well as personal credit portfolios to provide the Bank with an overview of the situation. By simulating very specific extreme scenarios, these tests enable the Bank to measure the level of regulatory capital necessary to absorb potential losses and determine how solvent it would be if the scenarios were to play out.

Credit-granting process

Credit-granting decisions are based first and foremost on the results of the risk assessment. In addition to the client's solvency, credit-granting decisions are also influenced by factors such as available collateral, transaction compliance with policies, standards and procedures, and the Bank's overall risk-adjusted return objective. Each credit-granting decision is made by authorities within the risk management teams and management who are independent of the business units and are at a reporting level commensurate with the size of the proposed credit transaction and the associated risk.

Decision-making authority is determined in compliance with the delegation of authority set out in the Credit Risk Management Policy. A person in a senior position in the organization approves credit facilities that are substantial or carry a higher risk for the Bank. The Bank's Global Risk Committee approves and monitors all substantial credit facilities. Credit applications that exceed management's latitudes are submitted to the Board for approval. The credit granting process demands a high level of accountability from managers, who must proactively manage the credit portfolio.

Risk mitigation

The Bank also controls credit risk with various risk mitigation techniques. In addition to the usual technique of requiring collateral to guarantee repayment of the credit it grants, the Bank uses protection mechanisms such as credit derivative financial instruments and securitization, syndication and loan assignments as well as an orderly reduction in the amount of credit granted, if required.

The most common method used to mitigate credit risk is to obtain quality collateral from counterparties. In the Bank's opinion, obtaining collateral cannot replace a rigorous assessment of a counterparty's ability to meet its obligations, but, beyond a certain risk threshold, it is an essential complement. Collateral is not required in all cases. It depends upon the level of risk presented by the borrower and the type of loan granted. However, if the level of risk to the Bank is considered high, the counterparty will likely be asked to pledge collateral. The legal validity of any collateral obtained and the Bank's ability to correctly measure the collateral's value on a regular basis are critical for this mechanism to play its proper role in risk mitigation. The Bank has established specific requirements in its internal policies with respect to the appropriate legal documentation and assessment for the kinds of collateral that business units may require in guarantee of loans granted. The categories of eligible collateral and the lending value of these assets have also been defined by the Bank. For the most part, they include the following asset categories:

- accounts receivable
- inventories
- machinery and equipment and rolling stock
- real estate mortgages on residential, commercial and office buildings and on industrial facilities
- cash and marketable securities

Portfolio diversification and management

The Bank is exposed to credit risk not only through outstanding loans and undrawn amounts to a particular borrower, but also through the sectoral distribution of loans outstanding, undrawn amounts, and the exposure of its various credit portfolios to geographical, concentration and settlement risks.

The Bank's approach to controlling these diverse risks begins with optimizing diversification of its exposures. The management criteria set out in its internal policies and procedures include measures designed to maintain a healthy degree of diversification of credit risk in its portfolios. These instructions are mainly reflected in the application of various limits on the scope of its exposures: credit approval limits and country limits by hierarchical level; limits on counterparty credit concentration; and credit concentration limits by industry, country, region and type of financial instrument. Compliance with these limits is monitored through periodic reports submitted by Risk Management officers to the Board.

The criteria established for portfolio diversification and the specific limits set for economic, industrial or geographical sectors are based on the findings of sector-based studies and analyses conducted by economists and the Bank's Risk Management Group, and are approved by the Global Risk Committee. Continuous analyses are performed in order to anticipate problems with a sector or borrower before they materialize as defaulted payments.

Financial market instruments

The mitigation techniques for the credit risk on commitments related to transactions involving financial instruments are somewhat different from those used for loans and advances. The mechanisms used depend on the nature of the instrument or the type of contract traded.

Obligations related to the trading of contracts on derivative financial instruments are frequently subject to credit risk mitigation measures. The first of these, and the most widely used, is the signing of International Swaps & Derivatives Association, Inc. (ISDA) master agreements with the appropriate counterparties. These agreements make it possible to apply full netting of the gross amounts of the market price assessments, when one of the contracting parties defaults on the agreement, for each of the transactions covered by the agreement and in force at the time of default. The amount of the final settlement is therefore the net balance of gains and losses on each transaction, which increases the likelihood of recovery when a counterparty defaults. The Bank's policies require signing an ISDA agreement with each counterparty trading derivative financial instruments with its traders. Under certain conditions, foreign exchange contracts are exempt from this rule, but the Bank prefers signing ISDA agreements as often as possible.

Another mechanism for reducing credit risk complements the ISDA master agreement in many cases and provides the Bank and its counterparty (or both parties, if need be) with the right to request collateral from the counterparty when the net balance of gains and losses on each transaction exceeds a threshold defined in the agreement. These agreements, known as Credit Support Annexes (CSAs), are common between financial institutions active in international financial markets since they make it possible to limit credit risk while providing traders with additional flexibility to continue trading with the counterparty. The Bank has greatly increased its use of this type of legal documentation over the last few years. The Bank's internal policies set the conditions governing the implementation of such agreements.

Requiring collateral as part of a securities lending transaction or reverse repurchase agreement is not solely the result of a credit decision. In such cases, it is a mandatory market practice imposed by self-regulating organizations such as the Investment Industry Regulatory Organization of Canada.

In accordance with its collateral pledging policy, the Bank conducts simulations of potential counterparty collateral claims under CSAs in effect, in the event of a Bank downgrade or other unlikely occurrences. The simulations are based on various Bank downgrading scenarios or market value fluctuations of transactions covered by CSAs.

Other risk mitigation methods

Credit derivative financial instruments

To some extent, the Bank also reduces credit risk by using the protection provided by derivative financial instruments such as credit default swaps. When the Bank acquires credit protection, it pays a premium on the swap to the counterparty in exchange for the counterparty's commitment to pay if the underlying entity defaults or another event involving that entity and covered by the legal agreement occurs. Since, like borrowers, providers of credit protection must receive a default risk rating, the Bank's internal policies set out all the criteria under which a counterparty may be judged eligible to mitigate the Bank's credit risk.

Loan syndication

For loan syndication, the Bank has developed specific instructions on the appropriate objectives, responsibilities and documentation requirements.

Securitization

Securitization represents a means for transferring to a third party a portion of the credit risk incurred on loans originally granted by the Bank. A more detailed analysis of this activity is provided in this report's section on *Off-Balance Sheet Arrangements* on pages 48 and 50.

Account follow-up and recovery

Credit granted and borrowers are monitored on an ongoing basis and in a manner commensurate with the related risk. Loan portfolio managers rely on an array of methods to conduct a particularly rigorous follow-up on problem loans. When loans continue to deteriorate and there is an increase in risk to the point where monitoring has to be increased, a group specialized in managing problem accounts steps in to maximize collection of the disbursed amounts and tailor strategies to these accounts.

In these cases, loan portfolio managers prepare and submit, to the concerned credit department, a detailed monitoring report each month to track the status of at-risk obligors and the corrective measures undertaken. The management of each credit department concerned performs follow-ups on the reports, and each quarter the Credit Monitoring Committee meets to review the action plans and monitoring reports of obligors that have loans disbursed and undrawn amounts of \$2 million or more. The authority to approve allowances for credit losses is attributed using limits delegated on the basis of hierarchical level under the credit risk management policy.

Detailed information on the recognition of impaired loans and allowances for credit risk are presented in Note 1 to the consolidated financial statements.

Counterparty risk

Counterparty risk is a credit risk that the Bank incurs on various types of transactions involving financial instruments. The most significant risks are those it faces when it trades derivative financial instruments with counterparties on the over-the-counter market or when it purchases securities under reverse repurchase agreements or sells securities under repurchase agreements. Securities lending transactions and securities brokerage activities are also a source of counterparty risk. Note 29 to the consolidated financial statements provides a complete description of this risk for financial instruments by type of product traded. The Risk Management Group has developed models by broad category of financial instruments so that it can use an advanced methodology for the purposes of calculating economic capital and establishing internal limits for the Financial Markets segment.

The Bank's credit policies and holdback reserves for trading portfolios set out the rules to follow when establishing holdback reserves for the credit risk associated with trading activities and for obtaining the collateral required to minimize this risk. These policies cover methodological considerations as well as the guidelines and processes to be applied. The mechanism used to monitor collateral is presented in the section on risk mitigation.

The Bank has identified circumstances in which it is likely to be exposed to wrong-way risk, which is generally associated with exposure to counterparty risk and characterized by higher risk for the Bank if a counterparty's probability of default increases (unfavourable positive correlation). A common wrong-way risk arises from the trading of derivatives contracts with counterparties where the underlying assets may include equity securities issued by those counterparties.

Settlement risk

Settlement risk occurs in any transaction that features simultaneous payment or settlement reciprocity between the Bank and a counterparty. Foreign exchange contracts represent an example of transactions that can generate significant levels of settlement risk. However, the implementation of multilateral settlement systems that allow settlement netting among participating institutions (e.g., CLS Settlement) has contributed greatly to reducing the risks associated with the settlement of foreign exchange transactions among banks.

There are several other types of transactions that may generate settlement risk, in particular the use of electronic fund transfer services. This risk is associated with the possibility that the Bank may make a payment or settlement on a transaction without receiving the amount required from the counterparty, leaving the Bank with no opportunity to recover the funds delivered.

The ultimate means for completely eliminating such a risk is for the Bank to complete no payments or settlements before receiving the funds due from the counterparty. Such an approach cannot, however, be used systematically. For several electronic payment services, the Bank is able to implement mechanisms that allow it to make its transfers revocable, or to debit the counterparty in the amount of the settlements before it makes its own transfer. On the other hand, the nature of transactions in financial instruments makes it impossible for such practices to be widely used. For example, on foreign exchange transactions involving a currency other than the U.S. dollar, time zone differentials impose strict payment schedules on the parties. The Bank cannot unduly postpone a settlement without facing significant penalties, due to the large size of amounts involved. The most effective way for the Bank to control settlement risks, both for financial market transactions and irrevocable transfers, is to impose internal risk limits based on the counterparty's ability to pay.

Market risk management

Market risk is intrinsically interlinked with participation in financial markets. Managing this risk is a core competency for the Bank in its trading, investing and asset/liability management activities.

Assessing market risk

An integrated internal control framework is used to manage market risk, which is overseen by the Market Risk Management Committee. The Bank is adapting its market risk management and oversight framework based on recent regulatory changes, including new rules on measuring "value at risk", ((VaR) exposure to risk) in crisis situations (Stressed VaR) and assessing specific risk.

A comprehensive policy governs global market risk management across the Bank's units and subsidiaries. The policy describes the main mechanisms for identifying and measuring the types of market risk to which the Bank is exposed, including both primary (e.g., interest rate, foreign exchange, etc.) and secondary risks (volatility, correlation, specific risk, etc). Risk tolerance thresholds are established using a hierarchy of varied limits (e.g., VaR, stop-loss) allocated by portfolio, trading unit, unit manager and officer and an appropriate exceeding escalation process. The policy also sets out rules determining whether financial instruments are eligible for inclusion in trading portfolios versus investment portfolios (available-for-sale financial assets). Lastly, the Bank has implemented separate policies covering the independent valuation of financial instrument positions and valuation adjustments on trading portfolios.

The Risk Management Group uses a variety of market risk measurement mechanisms to control and monitor exposure, the main one being the Value-at-Risk (VaR) simulation model. VaR has the advantage of providing a uniform measurement of financial instrument-related market risks based on a single statistical confidence level and time horizon. It is the maximum value of simulated daily losses, in the portfolios held, measured at a 99% confidence level, which means that actual losses may be likely to exceed the value only one day out of 100. The holding period, i.e. the expected timeframe for liquidating a position, is one day for trading portfolios. VaR is calculated on a daily basis both for major classes of financial instruments (including derivative financial instruments) and all portfolios of the Financial Markets segment of the Bank. By calculating this value, the Bank seeks to ensure that trading and investment decisions do not entail risks in excess of preset limits. The VaR calculation model is based on a historical simulation methodology using two years of data.

Outstanding VaR is monitored daily in relation to established limits for each type of market risk, portfolio and business unit, as well as by major type of activity: trading, investment and asset/liability management. Furthermore, investment activities, i.e., available-for-sale securities, are governed by an investment guideline in addition to the Market Risk Management Policy. In addition, an overall VaR limit is set for asset and liability management, also known as structural interest rate risk management. The overall VaR limits by major portfolio and the Bank's consolidated limit covering all financial market operations are approved by the Board of Directors. The ARMC reviews VaR results on a quarterly basis, notably a summary of situations where the Board was required to authorize breaches of the approved limits.

Moreover, the Bank also carries out backtesting which is essential to verify the capacity of the Bank's VaR model to adequately forecast the maximum risk of market losses and thus validate, retroactively, the quality and accuracy of the results obtained using the model. Other limits are used in tandem with VaR to control the associated residual risks, in particular, concentration, volatility and liquidity risk.

Stress tests and sensitivity analyses

The VaR model simulates losses in market situations similar to those revealed by historical data, i.e., market conditions that are supposedly normal. The Bank also simulates the impact of abnormal situations, i.e., rare extreme events (such as a stock market crash) on the various portfolios of the Financial Markets segment. It does this by carrying out daily stress tests as well as sensitivity analyses for all risk categories: interest rate risk, equity and commodity price risk, foreign exchange risk and market volatility risk. Lastly, VaR exposure itself is stress-tested in an extreme scenario.

This battery of stress tests and sensitivity analyses simulate the results that the portfolios of the Financial Markets segment would generate if the extreme scenarios in question were to occur. Stress tests and sensitivity analyses are subject to maximum potential loss limits, which are approved by the Board. These tests and analyses are jointly established by the Risk Management Group and the management of the business units. They are regularly reviewed in light of changes in market conditions, new products and trading strategies.

Trading activities

The Bank holds trading portfolios for market making, trading on its own behalf, liquidity for its institutional clients and the sale of financial products.

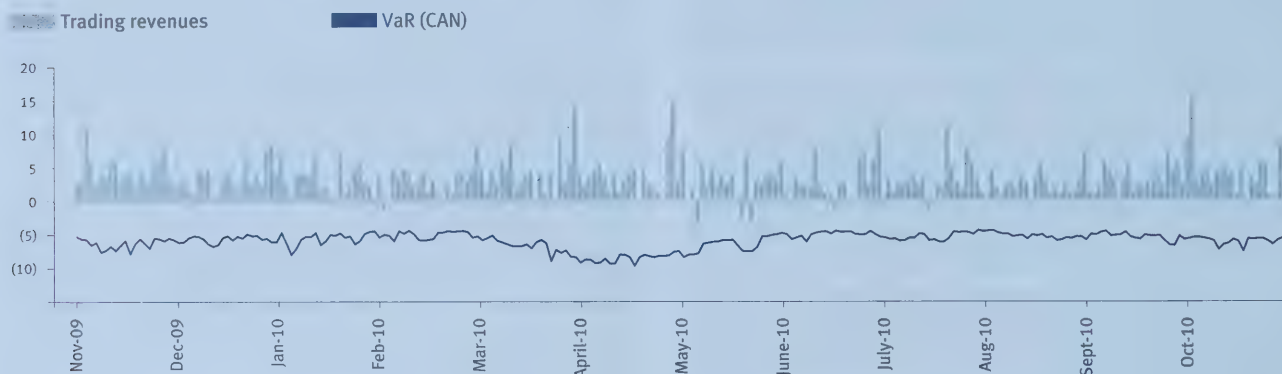
The Bank assesses the specific risk of the shares held in its trading portfolios using an internal model. This risk represents a particular variant of market risk associated with unfavourable changes in market prices due to factors associated with the issuer of a security, and it applies as much to debt securities as to share prices.

The following table shows daily trading revenues and VaR. The table showing the VaR distribution of trading portfolios by risk category, as well as correlation effect, is presented in Note 5 to the consolidated financial statements in the *Market Risk Management* section. As shown in the table, the global VaR of trading activities is usually lower than the VaR of the individual portfolios, which shows correlation effect.

Daily trading revenues were positive more than 93% of the days in the year ended October 31, 2010. Net daily trading losses in excess of \$1 million were recorded on only 7 days. None of these losses exceeded the VaR limit.

Daily trading revenues

(millions of dollars)



Structural interest rate risk

As part of its non-trading activities, such as granting mortgage loans and accepting term deposits, the Bank is exposed to structural interest rate risk. Interest rate movements cause changes in interest income and interest expense and, although these changes move in the same direction, their relative magnitude will have a favourable or unfavourable impact on annual net interest income and the economic value (present value of estimated cash flows) of shareholders' equity. The extent of that impact depends on several factors, including asset and liability matching and the interest rate curve. Assets and liabilities are managed to optimize the impact of interest rate movements in view of anticipated rate changes.

Regular simulations are performed to assess the impact of various scenarios on annual net interest income and on the economic value of shareholders' equity and to guide the management of structural interest rate risk.

Interest rate risk management is managed under a specific policy, the revision and application of which are overseen by various management committees, among others. The policy sets risk limits based on the impact of interest rates fluctuations on the following parameters: annual net interest income and economic value. In addition, the duration of shareholders' equity must be kept within certain limits.

The table presented in Note 5 to the consolidated financial statements in the *Market risk management* section provides the potential before-tax impact of an immediate and sustained 100-basis-point increase or decrease in interest rates on net interest income and on the economic value of shareholders' equity of the Bank's non-trading portfolios, assuming no further hedging is undertaken.

Structural foreign exchange risk

The Bank's structural foreign exchange risk arises from investments in self-sustaining foreign operations denominated in currencies other than the Canadian dollar. This risk is measured by assessing the impact of currency fluctuations. The Bank uses financial instruments (derivative or non-derivative) to hedge structural foreign exchange risk. In a hedge of a net investment in a self-sustaining foreign operation, the financial instruments used will offset foreign exchange gains and losses on the investments. Management of this risk is governed by a specific policy submitted to the Board of Directors.

Available-for-sale securities portfolios

The Bank has created available-for-sale securities portfolios in liquid or non-liquid securities for strategic, long-term investment and liquidity purposes. These investments carry not only market risk, but also credit risk, liquidity risk, concentration risk and reputational risk as well as risk of non-compliance with laws and regulations in effect.

The Investment Guidelines set out the guiding principles and general management standards to be followed by all those who manage portfolios of available-for-sale securities included in the portfolios of the Bank and its subsidiaries. Under these guidelines, business units that are active in managing this type of portfolio are required to have internal investment policies that set, among other things, targets and limits for the allocation of assets in the portfolios concerned and internal approval mechanisms. The primary objective is to reduce concentration risk by industry, issuer, country, type of financial instrument and credit quality. Overall limits are set on the total amount of non-liquid securities in the *Available-for-sale securities* portfolios in proportion to the Bank's equity, in the total invested in liquid equity securities excluding preferred shares and in the overall exposure to common shares with respect to an individual issuer. Lastly,

the Bank has a specific strategic investment policy that is also approved by the Board which defines strategic investments as purchases of business assets or acquisitions of deemed material equity stake in an entity for purposes of acquiring control or creating a long-term relationship.

Available-for-sale securities – Debt securities

In keeping with the Bank's regulatory capital requirement commitments for credit risk management, the Bank adopted the Advanced Internal Rating-Based Approach ("Advanced IRB") for credit risk effective November 1, 2009 and has applied this approach in assessing regulatory capital adequacy since the first quarter of 2010. Under the Basel II Accord, the Bank met the Superintendent's Advanced IRB Approach requirements and demonstrated that its presentation of capital is accurate and of high quality.

Available-for-sale securities – Equity securities

For assets in the form of equity securities, which comprise common shares, perpetual or convertible preferred shares, mezzanine debt with warrants and mutual funds, the Bank adopted, on November 1, 2009, an approach related to the Advanced Approach for Capital Adequacy Requirements, namely the simple risk weight method under the "market-based" approach, as the term is used in the Basel II Accord. This approach requires proactive management of the capital allocated to portfolios with equity securities since, beyond a certain threshold, the cost of regulatory capital becomes prohibitive. The prescribed risk factors are 24% for listed equity securities and 32% for unlisted equity securities.

The Investment Guidelines require that the Bank's investments in equity securities in *Available-for-sale securities* portfolios that meet certain materiality criteria be approved by an additional authority to the one within the business unit in question. In this way, the Bank ensures that any investment decision whereby the Bank acquires a significant interest in the equity of a company or assumes a high monetary risk are known and approved by the Bank's senior management. Moreover, given the impact of investments in available-for-sale equity securities on capital requirements, all decisions involving significant investments in shares are subject to an assessment of the regulatory cost of capital before being formally accepted.

Liquidity risk management

Liquidity risk arises when sources of funds become insufficient to meet scheduled payments under the Bank's commitments. Liquidity risk stems from mismatched cash flows related to assets and liabilities as well as the characteristics of certain products, such as credit commitments and non-fixed term deposits.

The Bank's primary objective as a financial institution is to manage liquidity such that it supports the Bank's business strategy and enables it to honour its commitments when they come due, even in extreme conditions. This is done primarily by implementing a policy framework, approved by the Board, which establishes a risk tolerance threshold, monitoring structures controlled by the various committees, risk indicators, reporting procedures, delegation of responsibilities and segregation of duties.

Roles and responsibilities

Corporate Treasury manages liquidity and funding needs Bank-wide. These activities comprise:

- managing day-to-day cash flow, collateral and short-term funding;
- planning and issuing long-term funding and determining liquidity cost transfer pricing;
- developing and implementing the liquidity management and funding policy;
- monitoring, measuring and reporting on the Bank's exposure to liquidity risk; and
- establishing and maintaining an adequate risk assessment process and sound controls.

The Liquidity and Funding Committee, composed of Corporate Treasury and Risk Management Group representatives, reviews and assesses the Bank's liquidity position. The Asset and Liability Management Committee, which reports to the Global Risk Committee, oversees the Bank's liquidity management and funding framework and approves the strategy.

Liquidity management

The Bank's funds transfer pricing system prices liquidity by allocating the cost to the various operating segments or by compensating them, as applicable. Liquidity costs are allocated to liquidity-intensive activities, mainly illiquid long-term loans, commitments to extend credit, illiquid securities as well as strategic investments. The liquidity compensation is credited to their suppliers of funds, primarily funding in the form of core deposits and securities eligible as collateral by central banks.

Short-term day-to-day funding decisions are based on a daily cumulative net cash position, which is controlled by means of limits set on liquidity ratios. In addition, the Bank closely monitors the nominal value of new funds obtained on the wholesale market with terms of one to seven days.

Moreover, the Bank's collateral pledging activities related to derivative financial instrument transactions (exchange-traded and over-the-counter contracts) are tracked on a daily basis in relation to the global limit set by the Bank and are tested once a month using a series of simulations. In particular, the Bank uses various scenarios to estimate the potential amounts of additional collateral that could be demanded from it in the event its credit rating deteriorates. The Bank also regularly tracks unencumbered securities outstanding in proportion to its total assets and in proportion to unsecured institutional market funds due in less than one year. The Bank must hold unencumbered liquid assets outstanding at least equal to the total amount of wholesale funding maturing within one year.

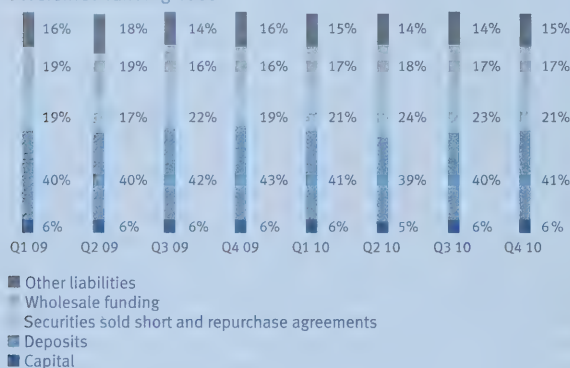
The Bank's survival period, an indicator designed to measure the number of days it would take to utilize the Bank's liquid assets if the Bank were to lose deposits prematurely or if funds from the wholesale market were not renewed at maturity, is measured monthly using six scenarios. A survival period limit is established on the basis of simulations of four of these scenarios. As at October 31, 2010, the Bank's consolidated surplus liquid asset position up to 90 days, measured in the course of normal operations, totalled \$21.4 billion compared to \$15.5 billion as at October 31, 2009. The surplus liquid asset position is total liquid assets, less secured and unsecured disbursement requirements and contingent liabilities.

Another indicator known as "net cash capital," calculated monthly, measures the portion of term loans being used to finance the Bank's illiquid assets. Moreover, the Bank closely monitors its financial leverage to ensure that its assets-to-capital multiple respects the level prescribed by the Superintendent. Lastly, the Bank maintains up-to-date a liquidity contingency plan describing the measures to be taken in the event of a critical liquidity situation. This plan is reviewed and approved by senior management.

Funding

Core deposit liabilities are the Bank's primary funding source. In this context, diversification of funding by origination and term structure is an important element of a liquidity management strategy. The Bank seeks to diversify its funding sources by geographic location, currency, instrument, maturity and depositor. The first table below shows the soundness of the funding structure. In addition, the Bank is actively involved in securitization programs (e.g., residential mortgages and credit card receivables) that give it access to long-term funding. The second table below shows the maturity profile of wholesale funding.

Diversified funding base



Long-term wholesale funding maturity profile
(millions of dollars)



Operational risk management

Operational risk is present in every activity of the Bank. Fraud and unauthorized activities, system failures, human error, changes to or failure to comply with legal or regulatory requirements, litigation with clients and damage to physical property are just a few of the events which, because they can result in financial losses for the Bank or adversely affect its reputation, are considered operational risks.

Although operational risk cannot be eliminated entirely, it can be managed in a thorough, transparent manner to keep it at an acceptable level. Each business unit has assigned specific risk management responsibilities to employees of the unit to ensure proactive management of the unit's operational risks. In addition, the business unit's management monitors losses and operational risks, as well as events observed in other financial institutions. If necessary, action plans are drawn up to improve the control environment.

The Operational and Reputation Risk Unit develops operational risk identification, measurement and monitoring standards and procedures and assists the business units in implementing them. This team collects and compiles data on the level of risk present in the business units and reports on its work to the Operational Risk Management Committee.

Collection and analysis of data on operational losses at the Bank

The Operational and Reputation Risk Unit has a process for collecting operational loss data across the Bank, including its subsidiaries. The information captured, namely the amount of each loss and a description of the triggering events, is fed into a centralized loss event database, which is used to better understand the root causes of operational losses and develop risk mitigation strategies.

Collection and analysis of data on operational events observed in the industry

The Bank also collects and analyzes information reported in the media on operational events experienced by other financial institutions in order to assess the effectiveness of its own risk management practices and reinforce them, if necessary.

Operational risk self-assessment

This formal self-assessment process gives each business unit the means to proactively identify key operating risks, evaluate the effectiveness of mitigating controls, and develop action plans to maintain such risks at acceptable levels.

Specialized risk assessment programs

Certain specialized groups have implemented programs with their own risk-specific policies and procedures as well as oversight mechanisms to ensure they are adhered to. Such specialized programs exist for managing:

- financial reporting risk
- technological risks and information security
- business continuity
- outsourcing risk
- fraud
- information confidentiality

Insurance program

In order to protect itself against any material losses related to its exposure to unforeseeable operational risks, the Bank also has adequate insurance, the nature and amount of which meet its enterprise-wide coverage requirements.

Regulatory capital

The Bank received regulatory approval to use the Standardized Approach to report regulatory capital for operational risk as of fiscal 2008.

Regulatory risk management

The Bank operates in a highly regulated industry. The diversity of its activities and its geographical reach in Canada and abroad add to this complexity, since its operations are overseen by various regulatory bodies and self-regulatory organizations.

The Bank ensures sound regulatory risk management by using a proactive approach and emphasizing the integration of regulatory requirements in its day-to-day operations, as well as ongoing communication to remind its employees of the importance of complying with laws and regulations.

Regulatory risk management ensures that events stemming from regulatory non-compliance that could have an impact on the activities and reputation of the Bank and its subsidiaries are proactively identified and understood and that mitigating strategies are implemented. It also allows the Bank to obtain reasonable assurance that it is in compliance with legislation, regulations, principles, standards, directives, guidelines, decisions, recommendations, codes of practice and voluntary commitments relevant to its operations.

The implementation of a regulatory risk management framework across the organization is entrusted to the Corporate Compliance Department, which is mandated to:

- make sure that policies and procedures that ensure compliance with the regulations in effect in all territories where the Bank and its subsidiaries operate, including regulations related to money laundering and terrorist financing activities, are in place and operational;
- develop compliance training and information programs for employees of the Bank and its subsidiaries;
- exercise independent oversight of compliance by the Bank and its subsidiaries with policies and procedures; and
- refer relevant matters with respect to compliance and money laundering and terrorist financing to the Bank's Board of Directors.

The Bank has high regulatory risk management standards in order to earn the trust of its clients, its shareholders, the market and the general public.

Reputational risk management

Reputational risk generally arises from a deficiency in managing another risk. The Bank's reputation may, for example, be adversely affected by non-compliance with laws and regulations or by process failures. All risks must therefore be managed effectively in order to protect the Bank's reputation.

The Bank seeks to ensure that its employees are constantly aware of the potential repercussions of their actions on the Bank's reputation and image. In addition to the previously discussed operational risk management initiatives, a variety of mechanisms are in place to support sound reputational risk management, including codes of professional conduct applicable to all employees, policies regarding ethics and corporate governance and appropriate training programs.

The Bank also has a policy, approved by the Board of Directors, that covers reputation risk stemming from complex structured financing transactions. The policy sets the reputational risk management rules and practices applicable to these transactions. The policy is complemented by the special provisions of the new products and activities policy with respect to implementing new structured investment products and derivatives, which determines the approvals required by the various committees that assess risk whenever new products are introduced within the business units. These provisions are intended, among other things, to provide oversight for the management of reputational risk, which may be material for such products. The new products and activities policy requires that any new product or activity for which the reputational risk is determined to be high be submitted to the Global Risk Committee for approval.

The activities of the Corporate Compliance Department, Legal Affairs Department, Corporate Secretary's Office, Public Relations Department and Investor Relations Department complete the reputational risk management framework.

Environmental risk management

Environmental risk means any impact of environmental problems that leads to a loss of financial or operational value or affects the Bank's reputation. This risk arises from commercial and operating activities. For example, environmental issues related to the purchase or sale, by clients of the Bank, of contaminated properties or large-scale development projects, could lead to the Bank being exposed to credit and reputational risk. The Bank would also be forced to deal with operational risk and the risk related to the legal environment when environmental issues arise in its branches or administrative offices.

In this context, the Risk Management Group develops requirements that are prescribed in the Bank's risk management policy in order to assess, control, monitor and reveal environmental risk. As a result, the Risk Management Group shoulders responsibility for monitoring activities, in addition to submitting the established policy to the Global Risk Committee and the Board of Directors for approval each year. For their part, the operating segments and centralized services must incorporate requirements and controls related to the management of environmental risk in their activities.

ADDITIONAL FINANCIAL INFORMATION

QUARTERLY RESULTS

(millions of dollars, except per share amounts)

	2010				
	Total	Q4	Q3	Q2	Q1
Income Statement data					
Net interest income	1,912	489	501	443	479
Other income	2,366	606	553	609	598
Total revenues	4,278	1,095	1,054	1,052	1,077
Provision for credit losses	144	37	28	36	43
Operating expenses	2,811	716	681	660	754
Income taxes (recovery)	221	28	64	76	53
Non-controlling interests	68	27	10	19	12
Net income	1,034	287	271	261	215
Earnings per common share					
Basic	\$ 5.99	\$ 1.67	\$ 1.57	\$ 1.51	\$ 1.23
Diluted	5.94	1.66	1.56	1.50	1.22
Dividends (per share)					
Common	\$ 2.48	\$ 0.62	\$ 0.62	\$ 0.62	\$ 0.62
Preferred					
Series 15	1.4625	0.3656	0.3656	0.3657	0.3656
Series 16	1.2125	0.3031	0.3031	0.3032	0.3031
Series 20	1.5000	0.3750	0.3750	0.3750	0.3750
Series 21	1.3438	0.3360	0.3360	0.3359	0.3359
Series 24	1.6500	0.4125	0.4125	0.4125	0.4125
Series 26	1.6500	0.4125	0.4125	0.4125	0.4125
Return on common shareholders' equity	17.0%	18.0%	17.7%	18.0%	14.3%
Total assets	145,301	146,333	150,705	134,321	
Long-term financial liabilities⁽¹⁾	2,033	2,019	1,976	2,022	
Net impaired loans	162	176	246	259	
Number of common shares outstanding (thousands)					
Average – Basic	162,054	162,372	162,133	161,978	161,730
Average – Diluted	163,337	163,751	163,259	163,298	163,036
End of period		162,772	162,340	162,228	161,810
Per common share					
Book value	\$ 37.59	\$ 36.01	\$ 34.48	\$ 34.63	
Stock trading range					
High	67.87	67.87	62.69	64.01	64.62
Low	54.45	55.53	54.45	56.62	56.51
Number of employees	18,322	18,438	18,248	17,946	
Number of branches in Canada	442	442	444	444	

(1) Subordinated debentures.

2009					2008				
Total	Q4	Q3	Q2	Q1	Total	Q4	Q3	Q2	Q1
1,966	465	454	560	487	1,852	619	446	361	426
2,165	627	678	471	389	1,785	146	611	526	502
4,131	1,092	1,132	1,031	876	3,637	765	1,057	887	928
305	54	46	41	164	144	49	30	34	31
2,662	700	663	654	645	2,695	770	659	634	632
252	69	110	80	(7)	167	(23)	95	28	67
58	28	10	15	5	(145)	(101)	(13)	26	(57)
854	241	303	241	69	776	70	286	165	255
\$ 4.96	\$ 1.40	\$ 1.79	\$ 1.41	\$ 0.36	\$ 4.69	\$ 0.37	\$ 1.73	\$ 1.01	\$ 1.58
4.94	1.39	1.78	1.41	0.36	4.67	0.37	1.73	1.00	1.58
\$ 2.48	\$ 0.62	\$ 0.62	\$ 0.62	\$ 0.62	\$ 2.48	\$ 0.62	\$ 0.62	\$ 0.62	\$ 0.62
1.4625	0.3656	0.3656	0.3657	0.3656	1.4625	0.3657	0.3656	0.3656	0.3656
1.2125	0.3031	0.3031	0.3032	0.3031	1.2125	0.3032	0.3031	0.3031	0.3031
1.5000	0.3750	0.3750	0.3750	0.3750	0.8692	0.3750	0.4942	—	—
1.3438	0.3360	0.3360	0.3359	0.3359	0.5596	0.5596	—	—	—
1.3765	0.4125	0.4125	0.4125	0.1390	—	—	—	—	—
1.3042	0.4125	0.4125	0.4792	—	—	—	—	—	—
15.6%	16.7%	22.1%	18.5%	4.6%	16.4%	5.0%	23.7%	14.3%	22.9%
	132,138	134,589	137,935	136,989		129,332	121,931	123,608	120,124
	2,017	2,023	2,095	2,348		2,255	2,182	1,683	1,656
	223	216	175	178		169	142	134	140
160,263	161,034	160,322	159,927	159,758	158,663	159,382	158,890	158,373	158,001
160,901	162,276	161,236	160,114	159,901	159,255	159,818	159,473	158,991	158,731
	161,201	160,604	159,883	159,679		159,447	159,115	158,364	158,141
	\$ 33.43	\$ 32.51	\$ 31.88	\$ 30.54		\$ 29.70	\$ 29.44	\$ 28.76	\$ 28.13
62.08	62.08	58.11	46.43	45.95	54.63	53.66	54.63	53.73	54.25
25.62	56.00	43.36	30.71	25.62	42.25	42.25	45.75	44.39	45.15
	17,747	17,772	17,343	17,199		17,146	17,232	17,093	16,856
	445	446	446	448		446	445	446	446

TABLE 1: OVERVIEW OF RESULTS

Year ended October 31
(taxable equivalent basis⁽¹⁾)
(millions of dollars)

	2010	2009	2008	2007	2006
Net interest income	2,118	2,095	1,978	1,244	1,406
Other income	2,366	2,184	1,867	2,378	2,569
Total revenues	4,484	4,279	3,845	3,622	3,975
Operating expenses	2,811	2,662	2,695	2,626	2,538
Contribution	1,673	1,617	1,150	996	1,437
Provision for credit losses	144	305	144	103	77
Income before income taxes and non-controlling interests	1,529	1,312	1,006	893	1,360
Income taxes	427	400	375	284	457
Non-controlling interests	68	58	(145)	68	32
Net income	1,034	854	776	541	871
Average assets	140,358	140,978	128,319	125,964	106,192

(1) See Financial Reporting Method on pages 18 and 19.

TABLE 2: FINANCIAL PERFORMANCE BY BUSINESS SEGMENT

Year ended October 31
(taxable equivalent basis⁽¹⁾)
(millions of dollars)

	2010	2009	2008	2007	2006
Personal and Commercial					
Net interest income	1,511	1,407	1,390	1,369	1,330
Average assets	60,671	56,070	52,306	48,874	46,182
Net interest income as a % of average assets	2.49%	2.51%	2.66%	2.80%	2.88%
Wealth Management					
Net interest income	108	127	137	117	120
Average assets	940	873	693	662	669
Financial Markets					
Net interest income	824	790	708	(26)	172
Average assets	92,990	97,805	87,196	88,854	69,255
Other					
Net interest income	(325)	(229)	(257)	(216)	(216)
Average assets	(14,243)	(13,770)	(11,876)	(12,426)	(9,914)
Total					
Net interest income	2,118	2,095	1,978	1,244	1,406
Average assets	140,358	140,978	128,319	125,964	106,192

(1) See Financial Reporting Method on pages 18 and 19.

TABLE 3 – OTHER INCOME

Year ended October 31
(taxable equivalent basis⁽¹⁾)
(millions of dollars)

	2010	2009	2008	2007	2006
Underwriting and advisory fees	268	267	233	295	290
Securities brokerage commissions	301	282	319	353	339
Deposit and payment service charges	229	230	228	229	223
Trading revenues (losses)	(78)	31	(247)	586	375
Gains (losses) on available-for-sale securities (before 2007: Investment account), net	113	(97)	(88)	(407)	180
Card service revenues	42	37	42	34	34
Lending fees	168	140	106	121	130
Insurance revenues	121	117	119	115	113
Revenues from acceptances, letters of credit and guarantee	146	119	77	68	68
Securitization revenues	289	351	226	179	175
Foreign exchange revenues	109	110	121	103	98
Trust services and mutual funds	374	327	354	367	317
Other	284	270	377	335	227
	2,366	2,184	1,867	2,378	2,569
Domestic	2,109	2,102	1,963	2,060	2,336
International					
United States	160	5	240	103	96
Other	97	77	(336)	215	137
Other income as a % of total revenues on a taxable equivalent basis ⁽¹⁾	52.8%	51.0%	48.6%	65.7%	64.6%
Other income as a % of total revenues on a taxable equivalent basis and excluding specified items ⁽¹⁾	52.6%	53.9%	48.4%	70.0%	64.2%

(1) See *Financial Reporting Method* on pages 18 and 19.

TABLE 4 – TRADING ACCOUNTS

Year ended October 31
(taxable equivalent basis⁽²⁾)
(millions of dollars)

	2010	2009	2008	2007	2006
Financial markets					
Equities	243	205	148	299	266
Fixed income securities	199	388	92	88	51
Commodities and foreign exchange	85	91	112	(7)	25
	527	684	352	380	342
Other segments	2	9	36	14	12
Total	529	693	388	394	354

(1) Including net interest income and other income, adjusted for non-controlling interests.

(2) See *Financial Reporting Method* on pages 18 and 19.

TABLE 5. PROVISIONS FOR CREDIT LOSSES

Year ended October 31
(millions of dollars)

	2010	2009	2008	2007	2006
Provision for credit losses					
Personal	95	95	75	62	53
Commercial	42	53	59	43	22
Corporate	2	27	2	—	4
Real estate	5	—	—	1	(2)
Other	—	4	(19)	(3)	—
Loan secured by restructured notes of the MAV conduits	—	—	4	—	—
Total	144	179	121	103	77
General allowance for credit risk ⁽¹⁾	—	126	23	—	—
Total provision for credit losses	144	305	144	103	77
Average loans and acceptances	59,059	56,236	53,053	50,408	49,392
Specific provision for credit losses as a % of average loans and acceptances	0.24%	0.32%	0.22% ⁽²⁾	0.20%	0.16%
Provision for credit losses as a % of average loans and acceptances	0.24%	0.54%	0.27%	0.20%	0.16%
Allowance for credit losses					
Balance at beginning	642	471	430	428	455
Provision for credit losses	144	305	144	103	77
Write-offs	(237)	(208)	(194)	(154)	(168)
Recoveries ⁽³⁾	89	74	91	53	64
Balance at end	638	642	471	430	428
Composition of allowances:					
Portion related to securities	2	2	2	2	2
Specific allowances	207	184	138	120	118
General allowance ⁽⁴⁾	429	456	331	308	308

(1) Provisions taken for credit facilities granted to clients holding restructured notes of the MAV conduits.

(2) Excluding the provision for losses on loans secured by restructured notes of the MAV conduits.

(3) Including exchange rate fluctuations.

(4) The general allowance for credit risk was established taking into account the Bank's overall credit portfolio, except for an amount of \$121 million (2009: \$148 million; 2008: \$23 million; 2007: nil; 2006: nil) created for loans and credit facilities secured by restructured notes of the MAV conduits.

TABLE 6 – OPERATING EXPENSES

Year ended October 31
(millions of dollars)

	2010	2009	2008	2007	2006
Salaries and staff benefits ⁽¹⁾	1,603	1,538	1,454	1,498	1,479
Occupancy	140	154	138	127	124
Technology	285	319	351	378	358
Amortization – premises and equipment	40	38	39	42	40
Amortization – technology	79	71	94	36	29
Communications	71	76	78	73	74
Professional fees ⁽¹⁾	204	180	214	180	133
Restructuring charges ⁽¹⁾	22	–	66	7	–
Advertising and external relations	50	49	43	47	49
Stationery	25	24	24	30	26
Travel	17	15	19	22	21
Security and theft	17	18	15	18	14
Capital and payroll taxes	59	50	54	50	67
Other	199	130	106	118	124
Total	2,811	2,662	2,695	2,626	2,538
Domestic	2,598	2,477	2,490	2,407	2,360
International					
United States	150	122	131	126	92
Other	63	63	74	93	86
Operating expenses as a % of total revenues on a taxable equivalent basis ⁽²⁾	62.7%	62.2%	70.1%	72.5%	63.9%
Operating expenses as a % of total revenues on a taxable equivalent basis and excluding specified items ⁽²⁾	60.4%	59.7%	64.7%	63.0%	64.2%

(1) The restructuring charges for 2010 include \$21 million in salaries and staff benefits and \$1 million in professional fees (2008: \$49 million in salaries and staff benefits and \$17 million in professional fees; 2007: \$4 million in salaries and staff benefits and \$3 million in occupancy expense).

(2) Adjusted for gains or losses attributable to third parties. See *Financial Reporting Method* on pages 18 and 19.

TABLE 7 – CHANGE IN AVERAGE VOLUME

Year ended October 31
(millions of dollars)

	2010		2009		2008		2007		2006	
	Average volume \$	Rate %	Average volume \$	Rate %	Average volume \$	Rate %	Average volume \$	Rate %	Average volume \$	Rate %
Assets										
Deposits with financial institutions	3,362	0.06	2,069	0.58	7,361	2.81	9,881	4.28	9,348	3.36
Securities	57,072	2.05	53,888	2.24	46,017	2.61	46,513	3.27	34,401	3.16
Residential mortgage loans	15,898	3.73	15,314	4.23	15,990	5.15	16,109	5.17	16,067	4.89
Personal loans and credit card receivables	19,282	3.39	16,726	3.61	13,965	6.07	12,030	6.69	10,381	6.34
Business and government loans	24,421	2.61	29,523	2.50	29,021	4.37	27,254	4.95	26,739	4.37
Net impaired loans	(205)	(0.78)	(116)	(1.29)	(164)	(0.79)	(171)	(0.58)	(181)	(0.39)
Interest-bearing assets	119,830	2.55	117,404	2.74	112,190	3.87	111,616	4.42	96,755	4.15
Other assets	20,528	–	23,574	–	16,129	–	14,348	–	9,437	–
Total assets	140,358	2.18	140,978	2.28	128,319	3.39	125,964	3.91	106,192	3.78
Liabilities and shareholders' equity										
Personal deposits	32,657	1.50	33,427	1.89	30,758	2.65	28,675	2.77	27,222	2.50
Deposit-taking institutions	7,466	0.28	8,380	0.71	8,162	3.07	10,559	4.48	9,916	3.44
Other deposits	39,946	0.75	35,846	1.11	34,378	2.01	32,309	4.22	26,972	3.40
	80,069	1.01	77,653	1.40	73,298	2.40	71,543	3.68	64,110	3.01
Subordinated debentures	1,895	5.32	2,030	5.01	1,886	5.21	1,940	5.14	1,592	5.67
Obligations other than deposits	32,489	0.80	31,857	0.80	31,652	1.92	33,876	2.80	25,402	2.55
Interest-bearing liabilities	114,453	0.82	111,540	1.00	106,836	2.22	107,359	3.43	91,104	2.85
Other liabilities	19,099	–	23,318	–	16,362	–	13,675	–	10,451	–
Shareholders' equity	6,806	–	6,120	–	5,121	–	4,930	–	4,637	–
Liabilities and shareholders' equity	140,358	0.67	140,978	0.79	128,319	1.85	125,964	2.93	106,192	2.45
Gross margin		1.51		1.49		1.54		0.98		1.33

TABLE 8 – DISTRIBUTION OF GROSS LOANS BY BORROWER CATEGORY

As at October 31
(millions of dollars)

	2010		2009		2008		2007 ⁽¹⁾		2006 ⁽¹⁾	
	\$	%	\$	%	\$	%	\$	%	\$	%
Residential mortgage	15,806	27.3	14,961	28.1	15,366	29.4	15,577	31.5	14,957	31.3
Personal ⁽²⁾	20,549	35.5	18,313	34.3	15,695	30.1	13,026	26.3	11,205	23.5
Non-residential mortgage	1,348	2.3	1,318	2.5	1,350	2.6	1,371	2.8	1,322	2.8
Agricultural, fishing and trapping	2,017	3.5	1,911	3.6	1,952	3.7	1,950	3.9	1,847	3.9
Financial institutions	3,557	6.2	3,022	5.7	3,428	6.6	4,012	8.1	5,056	10.6
Manufacturing	2,097	3.6	2,153	4.0	2,219	4.3	2,280	4.6	2,047	4.3
Construction and real estate	1,390	2.4	1,399	2.6	1,264	2.4	1,295	2.6	1,226	2.6
Transportation and communications	1,437	2.5	1,165	2.2	890	1.7	536	1.1	475	1.0
Mines, quarries and energy	728	1.3	1,109	2.1	1,456	2.8	1,247	2.5	1,223	2.6
Wholesale and retail	2,549	4.4	2,119	4.0	1,932	3.7	1,791	3.6	1,652	3.4
Services	3,567	6.2	3,253	6.1	4,190	8.0	3,803	7.7	4,701	9.8
Other	2,779	4.8	2,554	4.8	2,468	4.7	2,550	5.3	2,014	4.2
	57,824	100.0	53,277	100.0	52,210	100.0	49,438	100.0	47,725	100.0

(1) The corresponding figures for 2007 and 2006 are presented as at September 30.

(2) Including consumer loans, credit card receivables and other personal loans.

TABLE 9 – IMPAIRED LOANS

As at October 31
(millions of dollars)

	2010	2009	2008	2007	2006 ⁽¹⁾
Net impaired loans					
Personal ⁽¹⁾	47	56	47	39	31
Commercial	79	90	80	66	63
Corporate	15	72	32	19	20
Real estate	21	5	7	3	—
Other	—	—	3	2	2
Total impaired loans, net ⁽²⁾	162	223	169	129	116
Impaired loans, gross	369	407	307	249	234
Specific allowance for credit losses	207	184	138	120	118
Impaired loans, net	162	223	169	129	116
Provisioning rate	56.1%	45.2%	45.0%	48.2%	50.4%
As a % of average loans and acceptances	0.4%	0.4%	0.3%	0.3%	0.2%
As a % of common shareholders' equity	2.6%	4.1%	3.6%	3.0%	2.6%

(1) Including \$23 million of net consumer loans in 2010 (2009: \$32 million; 2008: \$23 million; 2007: \$24 million; 2006: \$20 million).

(2) Whenever a payment is contractually 90 days past due, loans are classified as impaired unless they are fully secured and collection efforts are reasonably expected to result in repayment of the debt within 180 days. Loans that are 180 days in arrears are impaired in all situations, except when they are guaranteed or insured by a Canadian government (federal or provincial) or a Canadian government agency; such loans are impaired at 365 days in arrears. Credit card receivables are written off when payments are 180 days in arrears.

As at October 31
(millions of dollars)

	2010		2009		2008		2007		2006	
	\$	%	\$	%	\$	%	\$	%	\$	%
Personal	34,112	41.7	34,609	46.0	33,098	43.5	30,215	42.7	29,092	40.5
Commercial	17,316	21.2	18,388	24.5	16,273	21.4	16,263	23.0	18,069	25.1
Purchased funds	30,357	37.1	22,173	29.5	26,651	35.1	24,320	34.3	24,756	34.4
Total	81,785	100.0	75,170	100.0	76,022	100.0	70,798	100.0	71,917	100.0
Domestic	71,872	87.9	65,461	87.1	68,887	90.6	57,624	81.4	61,910	86.1
International										
United States	7,876	9.6	7,114	9.5	2,858	3.8	7,338	10.4	1,851	2.6
Other	2,037	2.5	2,595	3.4	4,277	5.6	5,836	8.2	8,156	11.3
Total	81,785	100.0	75,170	100.0	76,022	100.0	70,798	100.0	71,917	100.0
Personal deposits as a % of total assets		23.5		26.2		25.6		26.7		24.9

TABLE 11 – RISK-WEIGHTED ASSETS

As at October 31
(millions of dollars)

	Balance sheet amount	Risk-weighted balance		Risk-weighted balance		Risk-weighted balance		Risk-weighted balance	
		Basel II	Basel I	Basel II	Basel I	Basel II	Basel I	Basel I	Basel I
	2010	2010	2010	2009	2009	2008	2008	2007	2006
Balance sheet assets									
Cash resources	2,013	435	392	386	386	589	575	488	2,077
Securities	53,068	2,041	2,510	1,413	2,672	2,957	2,957	3,050	2,083
Securitization	1,200	264	–	611	–	–	–	–	–
Secured mortgage loans	23,553	2,107	5,290	4,326	6,015	4,307	7,653	6,205	5,647
Other loans	44,513	18,610	28,438	23,298	25,712	22,653	23,095	22,318	21,727
Other assets	20,954	5,455	7,959	7,438	7,395	5,978	5,987	5,371	5,549
	145,301	28,912	44,589	37,472	42,180	36,484	40,267	37,432	37,083
General allowance for credit risk		–	429	456	456	331	331	308	308
Total balance sheet assets	145,301	28,912	45,018	37,928	42,636	36,815	40,598	37,740	37,391
Off-balance sheet assets									
Letters of guarantee and documentary letters of credit		1,076	1,223	1,476	1,476	1,674	1,674	1,107	1,096
Commitments to extend credit		5,634	7,283	4,989	6,621	4,074	5,126	5,174	5,085
Securitization		262	–	474	–	–	–	–	–
Derivative financial instruments ⁽¹⁾									
Interest rate contracts		1,118	334	424	296	364	248	96	122
Foreign exchange contracts		347	218	444	253	755	433	428	234
Equities, commodities and credit derivative contracts		592	1,992	2,854	1,535	1,827	1,046	1,223	499
Total off-balance sheet assets		9,029	11,050	10,661	10,181	8,694	8,527	8,028	7,036
Market risk items		3,226	2,819	3,894	3,459	6,623	5,765	3,568	2,871
Operational risk items		6,794	–	6,124	–	5,937	–	–	–
Adjustment factor		1,870	–	–	–	–	–	–	–
		49,831	58,887	58,607	56,276	58,069	54,890	49,336	47,298

(1) Since November 1, 2006, all derivative financial instruments have been recorded in the Consolidated Balance Sheet.

TABLE 12 – SOURCES OF REGULATORY CAPITAL

As at October 31
(millions of dollars)

	Basel II 2010	Basel I 2010	Basel II 2009	Basel I 2009	Basel II 2008	Basel I 2008	Basel I 2007	Basel I 2006
Total regulatory capital at beginning	8,399	8,533	7,679	7,717	6,116	6,116	6,607	5,925
Internally generated capital								
Net income	1,034	1,034	854	854	776	776	541	871
Dividends on common and preferred shares	(465)	(465)	(457)	(457)	(426)	(426)	(385)	(341)
	569	569	397	397	350	350	156	530
External financing								
Eligible subordinated debentures	(3)	(3)	(255)	(255)	512	512	(300)	347 ⁽¹⁾
Preferred shares	–	–	315	315	374	374	–	–
Innovative instruments	–	–	–	–	450	450	(53)	208
Common shares	82	82	80	80	81	81	64	54
Repurchase of common shares	–	–	–	–	–	–	(315)	(310)
Non-controlling interests in subsidiaries	6	6	1	1	–	–	8	(123)
	85	85	141	141	1,417	1,417	(596)	176
Other								
Unrealized foreign exchange gains (losses), net	(33)	(33)	(29)	(29)	127	127	(88)	(66)
Other ⁽²⁾	(323)	46	211	307	(331)	(293)	37	42
	(356)	13	182	278	(204)	(166)	(51)	(24)
Regulatory capital generated (used)	298	667	720	816	1,563	1,601	(491)	682
Total regulatory capital at end	8,697	9,200	8,399	8,533	7,679	7,717	6,116	6,607

(1) Including the issuance of \$500 million of subordinated debentures on November 2, 2006.

(2) Represents the change in the eligible amount of the general allowance, amounts of regulatory capital deducted for goodwill, the eligible deduction for intangible assets, investments in companies subject to significant influence and amounts related to securitization transactions.

As at October 31
(millions of dollars)

	Exposure at default ⁽²⁾	2010 ⁽¹⁾				2009 ⁽¹⁾
		Standardized Approach ⁽³⁾	AIRB Approach	Other	Risk-weighted assets Total	Risk-weighted assets Total
Credit risk						
Loans – Retail						
Residential mortgages	28,245	19	2,237		2,256	4,326
Qualifying revolving retail	5,217	–	1,123		1,123	–
Other retail	11,600	821	4,476		5,297	7,853
Loans – Non-retail						
Business	34,748	3,308	17,300		20,608	26,557
Sovereign	21,954	–	366		366	–
Bank	42,579	52	1,837		1,889	1,697
Banking book equities⁽⁴⁾	1,011	–	1,389		1,389	1,131
Trading portfolio	7,141	81	1,913		1,994	3,635
Securitization	3,293	–	526		526	1,085
	155,788	4,281	31,167		35,448	46,284
Regulatory scaling factor			1,870		1,870	
Other assets				2,493	2,493	2,305
Total – Credit risk	155,788	4,281	33,037	2,493	39,811	48,589
Market risk		2,490	736		3,226	3,894
Operational risk		6,794			6,794	6,124
Total risk-adjusted assets	155,788	13,565	33,773	2,493	49,831	58,607
Tier 1 capital ratio					14.0%	10.7%
Total capital ratio					17.5%	14.3%

(1) Since November 1, 2009, the Bank has been applying the Advanced Internal Rating-Based approach for credit risk; prior to that date, it had been using the Standardized Approach.

(2) Exposure at default is the expected gross exposure upon the default of an obligor. This amount is before any specific allowance or partial write-offs and does not reflect the impact of credit risk mitigation and collateral held.

(3) Risk-weighted assets under the Standardized Approach reflect the impact of credit risk mitigation and collateral held.

(4) All the equities held in the banking book as at October 31, 2009 are grandfathered under Basel II and thus subject to a 100% risk-weighting until the end of 2017.

TABLE 14 – REGULATORY CAPITAL AND CAPITAL RATIOS

As at October 31
(millions of dollars)
(in accordance with BIS guidelines)

	Basel II 2010	Basel I 2010	Basel II 2009	Basel I 2009	Basel II 2008	Basel I 2008	Basel I 2007	Basel I 2006
Tier 1 capital								
Common shareholders' equity	5,934	5,934	5,282	5,282	4,797	4,797	4,399	4,478
Unrealized foreign exchange gains (losses), net of hedging activities and after taxes, included in <i>Accumulated other comprehensive income</i>	(133)	(133)	(100)	(100)	(71)	(71)	(180)	(92)
Accumulated net after-tax unrealized losses on available-for-sale equity securities included in <i>Accumulated other comprehensive income</i>	–	–	(11)	(11)	(88)	(88)	–	–
Non-cumulative permanent preferred shares	1,089	1,089	1,089	1,089	774	774	400	400
Innovative instruments ⁽¹⁾	975	975	971	971	828	828	509	562
Non-controlling interests ⁽²⁾	25	25	19	19	18	18	17	9
	7,890	7,890	7,250	7,250	6,258	6,258	5,145	5,357
Less: Goodwill	(744)	(744)	(746)	(746)	(740)	(740)	(703)	(683)
Less: Intangible assets in excess of limit	–	–	(35)	(35)	–	–	–	–
Less: Gains on sales recorded upon securitizations	(40)	–	(36)	–	(38)	–	–	–
Less: Investment in companies subject to significant influence	(79)	–	(118)	–	–	–	–	–
Less: Deduction for securitization (restructured notes of the MAV conduits)	(57)	–	(50)	–	–	–	–	–
	6,970	7,146	6,265	6,469	5,480	5,518	4,442	4,674
Tier 2 capital								
Subordinated debentures	1,894	1,894	1,897	1,897	2,153	2,153	1,641	1,949
Eligible general allowances for credit risk	79	429	456	456	331	331	308	308
Accumulated net after-tax unrealized gains on available-for-sale equity securities included in <i>Accumulated other comprehensive income</i>	13	13	–	–	–	–	80	–
Excess Tier 1 qualifying innovative instruments ⁽¹⁾	–	–	4	4	147	147	–	–
	1,986	2,336	2,357	2,357	2,631	2,631	2,029	2,257
Less: Investments in companies subject to significant influence and the capital of insurance companies	(202)	(281)	(173)	(293)	(432)	(432)	(353)	(289)
Less: First-loss protection	–	–	–	–	–	–	(2)	(35)
Less: Deduction for securitization (restructured notes of the MAV conduits)	(57)	–	(50)	–	–	–	–	–
	1,727	2,055	2,134	2,064	2,199	2,199	1,674	1,933
Total capital	8,697	9,201	8,399	8,533	7,679	7,717	6,116	6,607
Regulatory capital ratios								
Tier 1 capital ratio	14.0%	12.1%	10.7%	11.5%	9.4%	10.1%	9.0%	9.9%
Total capital ratio	17.5%	15.6%	14.3%	15.2%	13.2%	14.1%	12.4%	14.0%
Tangible common equity ratio	9.8%	8.6%	6.9%	7.2%	6.4%	6.8%	6.8%	7.3%
Assets-to-capital multiple ⁽³⁾	15.9	16.0	15.4	15.2	16.7	16.6	18.7	17.8

(1) 400,000 NBC CapS II - Series 1 and 350,000 NBC CapS II - Series 2 issued by NBC Asset Trust presented in *Non-controlling interests* and the 225,000 NBC CapS - Series I issued by NBC Capital Trust.

(2) Excluding 400,000 NBC CapS II - Series 1 and 350,000 NBC CapS II - Series 2 issued by NBC Asset Trust, mutual funds and other entities consolidated pursuant to the application of AcG-15.

(3) The assets-to-capital multiple corresponds to total balance sheet assets and direct credit substitutes divided by total capital as defined by capital adequacy requirements.

CONSOLIDATED FINANCIAL STATEMENTS

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DECLARATION OF MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The consolidated financial statements of National Bank of Canada (the Bank) and the other financial information presented in the Annual Report were prepared by Management, which is responsible for their integrity, including the material estimates and judgments incorporated therein. The consolidated financial statements have been prepared in accordance with the *Bank Act* (Canada) and Canadian generally accepted accounting principles (GAAP).

Management maintains the accounting and internal controls necessary to discharging its responsibility, which is to provide reasonable assurance that the financial accounts are accurate and complete and that the Bank's assets are adequately safeguarded. Controls that are currently in place include quality standards on staff hiring and training; the implementation of organizational structures with clear divisions of responsibility and accountability for performance; the Code of Professional Conduct; and the communication of operating policies and procedures.

As Chief Executive Officer and as Chief Financial Officer, we have overseen the evaluation of the design and operation of the Bank's internal controls over financial reporting in accordance with *Multilateral Instrument 52-109, Certification of Disclosures in Issuers' Annual and Interim Filings*. Based on the evaluation work performed, we have concluded that the internal controls over financial reporting were effective as at October 31, 2010 and that they provide reasonable assurance that the financial information is reliable and that the Bank's consolidated financial statements have been prepared in accordance with Canadian GAAP.

The Board of Directors (the Board) is responsible for reviewing and approving the financial information contained in the Annual Report. Acting through the Audit and Risk Management Committee (the ARMC), the Board also oversees the presentation of the consolidated financial statements and ensures that accounting and control systems are maintained. Composed of directors who are neither officers nor employees of the Bank, the ARMC is responsible, through Internal Audit, for performing an independent and objective review of the Bank's internal control effectiveness, i.e., governance processes, risk management processes and control measures. Furthermore, the ARMC reviews the consolidated financial statements and recommends their approval to the Board.

The control systems are supported by the presence of Corporate Compliance, which exercises independent oversight in order to assist managers in effectively managing regulatory risk and to obtain reasonable assurance that the Bank is compliant with regulatory requirements.

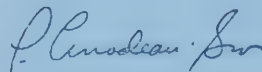
The Senior Vice-President of Internal Audit and the Vice-President of Corporate Compliance have direct access to the Chair of the ARMC and to the President and Chief Executive Officer.

In accordance with the *Bank Act* (Canada), the Superintendent of Financial Institutions regularly examines the affairs of the Bank to ensure that the Bank is in a sound financial condition and that depositors are protected.

The independent auditors, Samson Bélair/Deloitte & Touche s.e.n.c.r.l., whose report follows, were appointed by the shareholders on the recommendation of the Board. They had full and unrestricted access to the ARMC to discuss their audit and financial reporting matters.



Louis Vachon
President and Chief Executive Officer



Patricia Curadeau-Grou
Chief Financial Officer and Executive Vice-President
Finance, Risk and Treasury

Montreal, Canada, December 8, 2010

AUDITORS' REPORT

To the Shareholders of National Bank of Canada

We have audited the Consolidated Balance Sheets of National Bank of Canada (the Bank) as at October 31, 2010 and 2009 and the Consolidated Statements of Income, Comprehensive Income, Changes in Shareholders' Equity and Cash Flows for the years then ended. These financial statements are the responsibility of the Bank's Management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by Management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Bank as at October 31, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



Samson Bélair/Deloitte & Touche s.e.n.c.r.l.⁽¹⁾

Montreal, Canada, December 8, 2010

(1) Chartered accountant auditor permit No. 10288

CONSOLIDATED BALANCE SHEETS

(millions of dollars)

As at October 31	Notes	2010	2009
ASSETS			
Cash		261	296
Deposits with financial institutions		2,013	1,932
Securities	9		
Available-for-sale	8	10,997	13,281
Held-for-trading	10	43,271	36,952
		54,268	50,233
Securities purchased under reverse repurchase agreements		10,878	7,637
Loans	5 and 11		
Residential mortgage		15,806	14,961
Personal and credit card		20,549	18,313
Business and government		21,469	20,003
		57,824	53,277
Allowances for credit losses		(636)	(640)
		57,188	52,637
Other assets			
Customers' liability under acceptances		5,946	5,733
Fair value of derivative financial instruments	29	8,120	7,516
Premises and equipment	14	381	362
Goodwill	15	744	746
Intangible assets	15	480	397
Due from clients, dealers and brokers		2,909	2,578
Other	16	2,113	2,071
		20,693	19,403
		145,301	132,138
LIABILITIES AND SHAREHOLDERS' EQUITY			
Deposits	5 and 17		
Personal		34,112	34,609
Business and government		41,985	36,698
Deposit-taking institutions		5,463	3,638
Deposit from NBC Capital Trust		225	225
		81,785	75,170
Other liabilities			
Acceptances		5,946	5,733
Obligations related to securities sold short		18,292	13,221
Securities sold under repurchase agreements		12,513	12,736
Fair value of derivative financial instruments	29	6,631	5,947
Due to clients, dealers and brokers		3,131	3,017
Other	19	6,563	6,623
		53,076	47,277
Subordinated debentures	20	2,033	2,017
Non-controlling interests	21	1,199	1,197
Shareholders' equity			
Preferred shares	22	1,089	1,089
Common shares	22	1,804	1,729
Contributed surplus	24	66	48
Retained earnings		4,081	3,515
Accumulated other comprehensive income		168	96
		7,208	6,477
		145,301	132,138

Louis Vachon
President and Chief Executive Officer

Paul Gobeil
Director

CONSOLIDATED STATEMENTS OF INCOME

(millions of dollars)

Year ended October 31	Notes	2010	2009
Interest income			
Loans		1,924	2,029
Available-for-sale securities		216	399
Held-for-trading securities		748	756
Deposits with financial institutions		5	12
		2,893	3,196
Interest expense			
Deposits		599	820
Subordinated debentures		100	102
Other		282	308
		981	1,230
Net interest income		1,912	1,966
Other income			
Underwriting and advisory fees		268	267
Securities brokerage commissions		301	282
Deposit and payment service charges		229	230
Trading revenues (losses)	7	(78)	12
Gains (losses) on available-for-sale securities, net		113	(97)
Card service revenues		42	37
Lending fees		168	140
Insurance revenues		121	117
Revenues from acceptances, letters of credit and guarantee		146	119
Securitization revenues	11	289	351
Foreign exchange revenues		109	110
Trust services and mutual funds		374	327
Other		284	270
		2,366	2,165
Total revenues		4,278	4,131
Provision for credit losses	5	144	305
		4,134	3,826
Operating expenses			
Salaries and staff benefits		1,624	1,538
Occupancy		180	192
Technology		364	390
Communications		71	76
Professional fees		205	180
Other		367	286
		2,811	2,662
Income before income taxes and non-controlling interests		1,323	1,164
Income taxes	26	221	252
		1,102	912
Non-controlling interests	21	68	58
Net income		1,034	854
Dividends on preferred shares	22	63	59
Net income available to common shareholders		971	795
Number of common shares outstanding (thousands)	27		
Average – Basic		162,054	160,263
Average – Diluted		163,337	160,901
Earnings per common share (dollars)	27		
Basic		5.99	4.96
Diluted		5.94	4.94
Dividends per common share (dollars)	22	2.48	2.48

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(millions of dollars)

Year ended October 31

	2010	2009
Net income	1,034	854
Other comprehensive income, net of income taxes		
Net unrealized foreign currency gains (losses) on translating financial statements of self-sustaining foreign operations	(124)	(185)
Reclassification to net income of foreign currency (gains) losses on translating financial statements of self-sustaining foreign operations	1	–
Impact of hedging net foreign currency translation gains (losses)	92	156
Reclassification to net income of the impact of hedging foreign currency translation (gains) losses	(2)	–
Net change in unrealized foreign currency translation gains (losses), net of hedging activities	(33)	(29)
Net unrealized gains (losses) on available-for-sale securities	171	265
Reclassification to net income of (gains) losses on available-for-sale securities	(110)	(94)
Net change in unrealized gains (losses) on available-for-sale securities, net of fair value hedge transactions	61	171
Net gains (losses) on derivative financial instruments designated as cash flow hedges	50	62
Reclassification to net income of (gains) losses on derivative financial instruments designated as cash flow hedges	(6)	(46)
Net change in gains (losses) on derivative financial instruments designated as cash flow hedges	44	16
Total other comprehensive income, net of income taxes	72	158
Total comprehensive income	1,106	1,012

INCOME TAXES – OTHER COMPREHENSIVE INCOME

The income tax charge or recovery for each component of other comprehensive income is presented in the following table:

Year ended October 31

	2010	2009
Net unrealized foreign currency gains (losses) on translating financial statements of self-sustaining foreign operations	(7)	(8)
Impact of hedging net foreign currency translation gains (losses)	30	63
Net unrealized gains (losses) on available-for-sale securities	71	118
Reclassification to net income of (gains) losses on available-for-sale securities	(48)	(41)
Net gains (losses) on derivative financial instruments designated as cash flow hedges	22	22
Reclassification to net income of (gains) losses on derivative financial instruments designated as cash flow hedges	(2)	(21)
Total income taxes	66	133

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(millions of dollars)

Year ended October 31	Notes	2010	2009
Preferred shares at beginning		1,089	774
Issuances of preferred shares, Series 24 and 26	22	–	315
Preferred shares at end		1,089	1,089
Common shares at beginning		1,729	1,656
Issuances of common shares			
Dividend Reinvestment and Share Purchase Plan		29	29
Stock Option Plan		44	42
Other		2	2
Common shares at end	22	1,804	1,729
Contributed surplus at beginning		48	31
Stock option expense	24	14	13
Stock options exercised		(7)	(6)
Other		11	10
Contributed surplus at end		66	48
Retained earnings at beginning		3,515	3,110
Net income		1,034	854
Dividends			
Preferred shares	22	(63)	(59)
Common shares	22	(402)	(398)
Share issuance and other expenses, net of income taxes		(3)	8
Retained earnings at end		4,081	3,515
Accumulated other comprehensive income at beginning, net of income taxes		96	(62)
Net change in unrealized foreign currency translation gains (losses), net of hedging activities		(33)	(29)
Net change in unrealized gains (losses) on available-for-sale securities, net of fair value hedge transactions		61	171
Net change in gains (losses) on derivative financial instruments designated as cash flow hedges		44	16
Accumulated other comprehensive income at end, net of income taxes		168	96
Shareholders' equity		7,208	6,477

RETAINED EARNINGS AND ACCUMULATED OTHER COMPREHENSIVE INCOME, NET OF INCOME TAXES

As at October 31	2010	2009
Retained earnings	4,081	3,515
Accumulated other comprehensive income, net of income taxes	(133)	(100)
Unrealized foreign currency translation gains (losses), net of hedging activities		
Unrealized gains (losses) on available-for-sale securities, net of fair value hedge transactions	93	32
Gains (losses) on derivative financial instruments designated as cash flow hedges	208	164
	168	96
Total	4,249	3,611

CONSOLIDATED STATEMENTS OF CASH FLOWS

(millions of dollars)

Year ended October 31

	2010	2009
Cash flows from operating activities		
Net income	1,034	854
Adjustments for:		
Provision for credit losses	144	305
Amortization of premises and equipment and intangible assets	122	112
Impairment of an intangible asset	2	–
Future income taxes	2	70
Translation adjustment on foreign currency subordinated debentures	(3)	(5)
Losses (gains) on sales of available-for-sale securities, net	(122)	60
Other-than-temporary impairment charges	9	37
Gains on asset securitizations and other transfers of receivables, net	(233)	(302)
Stock option expense	14	13
Change in interest payable	(73)	(123)
Change in interest and dividends receivable	27	52
Change in income taxes payable	(180)	246
Change in fair value of derivative financial instruments, net	15	(360)
Change in held-for-trading securities	(6,319)	(3,089)
Contributions in excess of the employee pension plans expense	–	(192)
Change in amounts due from clients, dealers and brokers	(331)	(305)
Change in amounts due to clients, dealers and brokers	114	628
Change in other items	301	1,630
	(5,477)	(369)
Cash flows from financing activities		
Change in deposits	6,615	(852)
Issuances of common shares	68	67
Issuances of preferred shares	–	315
Repurchase of subordinated debentures	–	(250)
Share issuance expenses	–	(10)
Dividends paid on common shares	(330)	(373)
Dividends paid on preferred shares	(63)	(56)
Change in obligations related to securities sold short	5,071	(2,608)
Change in securities sold under repurchase agreements	(223)	5,585
Change in other items	393	(250)
	11,531	1,568
Cash flows from investing activities		
Change in deposits with financial institutions pledged as collateral	(185)	136
Change in loans (excluding securitization)	(8,998)	(5,302)
Proceeds from securitization of new assets and other transfers of receivables	4,753	4,101
Maturity of securitized assets	(450)	–
Purchases of available-for-sale securities	(17,565)	(42,067)
Sales of available-for-sale securities	19,719	40,634
Change in securities purchased under reverse repurchase agreements	(3,241)	231
Net change in premises and equipment and intangible assets	(226)	(228)
	(6,193)	(2,495)
Decrease in cash and cash equivalents	(139)	(1,296)
Cash and cash equivalents at beginning	2,170	3,466
Cash and cash equivalents at end	2,031	2,170
Cash and cash equivalents		
Cash	261	296
Deposits with financial institutions	2,013	1,932
Less: Amount pledged as collateral	(243)	(58)
	2,031	2,170
Supplementary information		
Interest paid	1,054	1,353
Income taxes paid	493	50

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(millions of dollars)

NOTE 1

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements of National Bank of Canada (the Bank) were prepared in accordance with section 308(4) of the *Bank Act* (Canada), which states that, except for as otherwise specified by the Superintendent of Financial Institutions (Canada) (the Superintendent), the consolidated financial statements are to be prepared in accordance with Canadian generally accepted accounting principles (GAAP).

Use of estimates and assumptions

The preparation of consolidated financial statements in accordance with Canadian GAAP requires Management to make estimates and assumptions that affect the carrying value of assets and liabilities on the balance sheet date, income and other related information. The most significant items for which Management has prepared estimates and assumptions are the allowances for credit losses, the fair value of financial instruments, the other-than-temporary impairment of available-for-sale securities, asset securitization, variable interest entities, goodwill and intangible assets, the impairment of long-lived assets, pension plans and other employee future benefits, income taxes, and the provision for contingencies. Accordingly, actual results could differ from these estimates, in which case the impact would be recognized in the consolidated financial statements in future fiscal periods.

Unless otherwise indicated, all amounts are expressed in Canadian dollars.

Basis of consolidation

The consolidated financial statements include the assets, liabilities, operating results and cash flows of all subsidiaries and variable interest entities (VIEs) where the Bank is the primary beneficiary, after elimination of intercompany transactions and balances.

VIEs are entities in which the holders of the equity investments at risk do not have a controlling financial interest or where the equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support provided by other parties. Accounting Guideline No. 15, *Consolidation of Variable Interest Entities* (AcG-15), of the Canadian Institute of Chartered Accountants (CICA) Handbook, requires the consolidation of a VIE by its primary beneficiary, defined as the party that absorbs the majority of the entity's expected losses, receives the majority of the entity's expected residual returns, or both.

Investments in companies over which the Bank exercises significant influence are accounted for using the equity method and are presented in *Other assets* in the Consolidated Balance Sheet. The Bank's share of income (loss) from these companies is included in *Other* under *Other income* in the Consolidated Statement of Income.

The proportionate consolidation method is used to account for investments in which the Bank exercises joint control, whereby only the Bank's pro rata share of assets, liabilities, revenues and expenses is consolidated.

Translation of foreign currencies

Foreign currency denominated monetary assets and liabilities of the Bank and its integrated branches and subsidiaries are translated into Canadian dollars at the rate in effect on the balance sheet date, whereas non-monetary assets and liabilities are translated into Canadian dollars at historical rates. Revenues and expenses denominated in foreign currencies are translated at the average exchange rates for the period. Translation gains and losses arising from operations in integrated branches and subsidiaries are recorded in *Other income* in the Consolidated Statement of Income, except for unrealized gains and losses on their available-for-sale securities, which are recorded in *Other comprehensive income*.

All foreign currency denominated assets and liabilities of self-sustaining foreign branches and subsidiaries are translated into Canadian dollars at the rate in effect on the balance sheet date, whereas the revenues and expenses of such foreign operations are translated into Canadian dollars at average exchange rates for the period. Gains and losses on translating the financial statements of self-sustaining branches and subsidiaries, along with related hedge and tax effects, are presented in *Accumulated other comprehensive income* in the Consolidated Balance Sheet. When there is a reduction in the net investment, an appropriate portion of these accumulated translation gains and losses is reclassified to *Other income* in the Consolidated Statement of Income.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

Classification and measurement of financial instruments

The accounting framework for financial instruments requires that all financial assets and liabilities be classified based on their characteristics, Management's intention, or the choice of category in certain circumstances. When they are initially recognized, all financial assets are classified as held-for-trading, held-to-maturity, available-for-sale, or loans and receivables, while financial liabilities are classified as held-for-trading or not held-for-trading. Debt securities that are not quoted in an active market can be classified as loans and receivables, and impairment is determined using the same model as that used for loans. Loans and receivables that the Bank intends to sell immediately or in the near term must be classified as held-for-trading, whereas loans and receivables for which the Bank may not recover substantially all of its initial investment, for reasons other than credit deterioration, must be classified as available-for-sale.

When they are initially recognized, all financial assets and liabilities, including derivative financial instruments, are recorded at fair value in the Consolidated Balance Sheet. In subsequent periods, they are measured at fair value, except for certain available-for-sale equity securities not quoted in an active market, which are recorded at cost, and items that are classified in the following categories, which are measured at cost or amortized cost calculated using the effective interest rate method: financial assets held-to-maturity, loans and receivables, and financial liabilities not held for trading.

Under the fair value option, a financial asset or liability may also be irrevocably designated as held-for-trading when it is first recognized. Financial instruments thus designated are accounted for under the fair value option, and any change in fair value is recorded in *Other income* in the Consolidated Statement of Income.

The Superintendent has issued guidelines limiting the circumstances under which the fair value option may be used. The Bank may use the option in the following cases:

- If, consistent with a documented risk management strategy, using this option allows the Bank to eliminate or significantly reduce the measurement or recognition disparity of measuring financial assets or liabilities on a different basis, and if the fair values are reliable; or
- If a group of financial assets and financial liabilities to which an instrument belongs is managed and its performance is evaluated on a fair value basis, in accordance with the Bank's documented risk management or investment strategy, and information is provided on that basis to senior management, and if the fair values are reliable. Consequently, the Bank may use the fair value option provided it has implemented a documented risk management strategy to manage the group of financial instruments together on the fair value basis and can demonstrate that significant financial risks are eliminated or significantly reduced, and if the fair values are reliable; or
- For hybrid financial instruments with one or more embedded derivatives that would significantly modify the cash flows of the financial instruments and that would otherwise be bifurcated and accounted for separately.

Reclassification of financial instruments

A financial asset, other than a derivative financial instrument or a financial asset that, upon initial recognition, was designated as held-for-trading, may be reclassified out of the held-for-trading category in rare circumstances if the financial asset is no longer held for the purpose of selling it in the near term. The financial asset must be reclassified at its fair value on the date of reclassification, and this fair value becomes its new cost or amortized cost, as applicable.

Cash and deposits with financial institutions

Cash and deposits with financial institutions consist of cash and cash equivalents as well as amounts pledged. Cash comprises cash on hand, bank notes and coin. Cash equivalents consist of deposits with the Bank of Canada, deposits with financial institutions – including net receivables related to cheques and other items in the clearing process – as well as the net amount of cheques and other items in transit.

Available-for-sale securities

Securities not classified as held-for-trading or as held-to-maturity, nor classified in the loans and receivables category, are classified as available-for-sale securities. The Bank accounts for available-for-sale securities transactions on the trade date and the related transaction costs are capitalized.

Available-for-sale securities are recognized at fair value, except for certain equity securities that do not have a quoted market price in an active market are therefore recognized at cost.

Unrealized gains and losses are recognized, net of income taxes, provided they are not hedged by derivative financial instruments in a fair value hedging relationship, in *Accumulated other comprehensive income*. In the event of disposal, the realized gains or losses, determined on an average cost basis, are reclassified to *Other income* in the Consolidated Statement of Income on the trade date.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

The amortization of premiums and discounts, under the effective interest rate method, as well as dividend and interest income, are recognized in *Interest income* in the Consolidated Statement of Income.

Available-for-sale securities are measured periodically to determine whether there is objective evidence of impairment. When determining whether there's objective evidence of impairment, the Bank considers the following factors: the significance of the decline in value below its cost or amortized cost, the duration of the decline in value, the financial condition and prospects of the issuer as well as the Bank's ability and intent to hold the investment until it recovers its fair value. If there is objective evidence of impairment and the decline in fair value below its cost or amortized cost is other than temporary, the accumulated loss previously recorded in *Accumulated other comprehensive income* is reclassified to *Other income* in the Consolidated Statement of Income. Impairment losses recognized in income relating to an available-for-sale debt security must be reversed in income when, in a subsequent period, the fair value of the security increases, and the increase can be objectively associated with an event occurring after the loss was recognized.

Held-for-trading securities

Held-for-trading securities are generally purchased for sale in the near term or are part of portfolios of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. The Bank accounts for held-for-trading securities transactions on the settlement date in the Consolidated Balance Sheet. Changes in fair value between the trade date and the settlement date are included in *Other income* in the Consolidated Statement of Income.

Held-for-trading securities are recorded at fair value, and any transaction fees are included directly in the Consolidated Statement of Income. Realized and unrealized gains and losses on such securities are recorded in *Other income* in the Consolidated Statement of Income. Dividend and interest income are recorded in *Interest income* in the Consolidated Statement of Income.

Securities purchased under reverse repurchase agreements and sold under repurchase agreements

The Bank purchases securities under reverse repurchase agreements and sells securities under repurchase agreements. The Bank records these transactions on the settlement date. Reverse repurchase agreements and repurchase agreements are treated as guaranteed loans and borrowings and are recorded in the Consolidated Balance Sheet at amortized cost using the effective interest rate method. Interest income from reverse repurchase agreements and interest expense from repurchase agreements are recorded in *Interest income* in the Consolidated Statement of Income.

Loans

Loans, including transaction fees directly attributable to the granting of the loans, other than loans classified or designated as held-for-trading, are reported in the Consolidated Balance Sheet at amortized cost calculated using the effective interest rate method. Loans classified or designated as held-for-trading are recognized at fair value.

A loan, other than a credit card receivable, is considered impaired when, in Management's opinion, there is no longer reasonable assurance of the timely collection of the full amount of principal and interest. Whenever a payment is contractually 90 days past due, loans are classified as impaired unless they are fully secured and collection efforts are reasonably expected to result in repayment of debt within 180 days. In all cases, loans that are more than 180 days past due are considered impaired, except when they are fully guaranteed or insured by a Canadian government (federal or provincial) or a Canadian government agency, in which case, they are classified as impaired when they are more than 365 days in arrears. Loans are returned to performing status when the timely collection of principal and interest is reasonably assured and when all principal and interest payments in arrears have been collected. Credit card receivables are written off when payments are 180 days in arrears.

When a loan is deemed impaired, interest ceases to be recorded and the carrying value of the loan is reduced to its estimated realizable amount by writing off all or part of the loan or by taking an allowance for credit losses.

Held-for-sale foreclosed assets in settlement of an impaired loan are accounted for at fair value less cost to sell at the date of foreclosure. Any difference between the carrying value of the loan before foreclosure and the initially estimated realizable amount of the assets is recorded under *Provision for credit losses*. For any subsequent change in their fair value, gains and losses are recognized under *Other income* in the Consolidated Statement of Income. Gains must not exceed the losses in value recognized after the foreclosure date. Revenue generated by foreclosed assets as well as the operating expenses are recorded in *Other* under *Other income* in the Consolidated Statement of Income.

Held-for-use foreclosed assets in settlement of an impaired loan are measured at fair value at the date of foreclosure. Any difference in the carrying value of the loan exceeding this fair value is recorded under *Provision for credit losses* in the Consolidated Statement of Income. Subsequent to the date of foreclosure, these assets are recorded as premises and equipment in accordance with the applicable accounting rules.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

Loan origination fees, including commitment, restructuring and renegotiation fees, are considered an integral part of the yield earned on the loan and are deferred and amortized to *Interest income* over the term of the loan. Direct costs for originating a loan are netted against origination fees. If there is a reasonable expectation that a commitment will result in a loan, commitment fees receive the same accounting treatment: they are amortized to *Interest income* over the term of the loan. Otherwise, they are included in *Other income* over the term of the commitment. Loan syndication fees are recorded in *Other income*, unless the yield on any loan retained by the Bank is less than that of other comparable lenders involved in the financing. In such cases, an appropriate portion of the fees is deferred and amortized to *Interest income* over the term of the loan. Certain mortgage loan prepayment fees are recognized as *Lending fees* in the Consolidated Statement of Income when earned. Commissions, if any, are amortized under the effective interest rate method.

Allowance for credit losses

The allowance for credit losses reflects Management's best estimate of losses in its credit portfolio as at the balance sheet date. This allowance relates primarily to loans but may also cover the credit risk associated with deposits with financial institutions, derivative financial instruments, loan substitute securities and other credit instruments such as acceptances, commitments to extend credit, letters of guarantee and letters of credit. The allowance for credit losses, which includes specific allowances for impaired loans and a general allowance for credit risk, is increased by the provision for credit losses charged to the Consolidated Statement of Income and decreased by the amount of write-offs net of recoveries.

Specific allowances are recorded in order to recognize the estimated losses for loans classified as impaired. Loans to businesses and governments include loans to businesses other than certain small businesses classified in the personal credit portfolios, government entities and financial institutions. The credit risk for these portfolios is assessed individually and on an ongoing basis, and the Bank records a specific allowance as soon as a loan is deemed impaired. The loans in these portfolios are written off when all reasonable collection efforts have been exhausted or if the borrower is bankrupt, liquidation is in process and further recovery of balances owing is not expected. Personal loans, which include residential mortgage loans, consumer loans and loans to certain small businesses, comprise a large number of homogeneous balances that are managed together, for which specific allowances are established on the basis of historical net write-off experience. Personal loans without collateral for which all the signatories have declared bankruptcy are automatically written off.

The allocated general allowance for credit risk represents Management's best estimate of probable losses in the portion of the credit portfolio that has not yet been specifically identified as impaired. This amount is determined by applying expected loss factors to outstanding loans and credit commitments. The allocated general allowance for the business and government loan portfolio is based on the application of expected default and loss factors, determined by statistical loss migration analysis, delineated by loan type, to which is added an additional amount that takes into account the discovery period and migration risk. For personal loans, the general allowance is based on specific parameters by product and no discovery period is calculated. Losses are determined by the application of loss ratios established through statistical analysis of loss migration over an economic cycle. The unallocated general allowance for credit risk is based on Management's assessment of probable losses in the portfolio that have not been captured by the allocated general allowance. This assessment takes into account general economic and business conditions, recent credit loss experience, and credit quality and concentration trends when the general allowance was created on the date of the Consolidated Balance Sheet. This allowance also reflects model and estimation risks. The unallocated general allowance does not represent future losses or serve as a substitute for the allocated general allowance.

Asset securitization

The Bank securitizes residential mortgage loans and credit card receivables by selling them to trusts that issue securities to investors. These transactions are recorded as sales when the Bank is deemed to have surrendered control over the assets sold and receives consideration other than beneficial interests in these assets. For control to be considered surrendered, the following conditions must be met:

- The transferred assets have been isolated from those of the Bank, even in bankruptcy or other receivership;
- The purchaser has the right to pledge or exchange the assets it received or, if the purchaser is a qualifying special-purpose entity (QSPE) as defined in CICA Accounting Guideline No. 12, *Transfers of Receivables* (AcG-12), each investor in the QSPE has the right to sell or pledge its beneficial interests in the QSPE; and
- The Bank does not maintain effective control over the transferred assets.

If these conditions are not all met, the sale is considered a secured borrowing, the assets remain on the Bank's Consolidated Balance Sheet and the proceeds are recognized as a liability.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

As part of securitization transactions, the Bank may retain certain interests in securitized receivables in the form of subordinated certificates, rights to future excess interest and, in some cases, a cash reserve account. Gains or losses on securitizations, net of transaction fees, are included in *Securitization revenues* in the Consolidated Statement of Income. Gains or losses recorded on the sale of receivables depend in part on the allocation of the previous carrying value of the receivables to the assets sold and the retained interests. This allocation is based on the relative fair value at the date of transfer. Fair value is based on market prices, when available. However, as quotes are usually not available for retained interests, the Bank estimates the initial and future fair values based primarily on the present value of expected future cash flows based on assumptions on weighted average terms, expected credit losses, prepayment rates, anticipated excess spreads (net of expected credit losses), and discount rates commensurate with the risks involved.

Retained interests are recorded at fair value and included in *Available-for-sale securities* on the Consolidated Balance Sheet. Changes in fair value are recognized in *Accumulated other comprehensive income*. If there is objective evidence of an other-than-temporary impairment in fair value, the accumulated loss reflected in *Accumulated other comprehensive income* is reclassified to *Gains (losses) on available-for-sale securities* in the Consolidated Statement of Income.

The Bank generally transfers receivables on a fully serviced basis. At the time of transfer, a servicing liability is recognized in the Consolidated Balance Sheet and recorded in the Consolidated Statement of Income over the term of the transferred receivables. This servicing liability is presented in *Other liabilities* in the Consolidated Balance Sheet.

Acceptances and customers' liability under acceptances

The potential liability of the Bank under acceptances is recorded as a liability in the Consolidated Balance Sheet. The Bank's potential recourse against clients is recorded as an equivalent offsetting asset. Fees are recorded in *Other income* in the Consolidated Statement of Income.

Premises and equipment

Buildings, equipment and furniture, leasehold improvements, and computer equipment leased under a capital lease are recognized at cost less accumulated amortization and are amortized over their estimated useful lives according to the following methods and rates. Land is recorded at cost.

	Methods	Rates
Buildings	(a) or (b)	2% to 14%
Equipment and furniture	(a) or (b)	10% to 50%
Leasehold improvements	(a)	(c)
Computer equipment leased under a capital lease	(a)	(c)

(a) Straight-line.

(b) Declining balance.

(c) Amortization period corresponds to the lesser of the useful life or the lease term plus the first renewal option, if applicable.

Premises and equipment are tested for impairment when events or changes in circumstances indicate that their carrying value might not be recoverable. The carrying value of a long-lived asset is not recoverable if it is greater than the undiscounted cash flows that would likely be generated from the use and eventual disposal of the asset. An impairment charge equal to the amount by which the carrying value exceeds fair value would then be recognized in the Consolidated Statement of Income.

Goodwill and intangible assets

The purchase method is used to account for the acquisition of subsidiaries. Goodwill represents the amount by which the price paid exceeds the fair value of the net assets acquired. Goodwill is tested for impairment annually or more frequently if changes in circumstances indicate that the asset might be impaired. The goodwill impairment test consists of comparing the carrying value of the reporting unit, including the allocated goodwill, with its fair value. A reporting unit is either a business segment or a component of a segment. If the carrying value of a reporting unit, including the allocated goodwill, exceeds its fair value, goodwill impairment is measured as the excess of the carrying value of the reporting unit's allocated goodwill over the implied fair value of the goodwill, based on the fair value of the assets and liabilities of the reporting unit. Any goodwill impairment is charged to the Consolidated Statement of Income in the period during which the impairment has been determined.

Intangible assets

Intangible assets of the Bank resulting from the acquisition of subsidiaries or groups of assets consist mainly of management contracts and are recorded at fair value at the time of acquisition. Since most of these assets have indefinite useful lives and therefore are not subject to amortization, they are tested for impairment annually or more frequently if changes in circumstances indicate that they might be impaired. The impairment test consists of comparing the fair value of the intangible asset with its carrying value. Any excess of the carrying value over the fair value is charged to the Consolidated Statement of Income in the period during which the impairment is determined. Certain intangible assets, such as software, with finite useful lives are amortized over their estimated useful lives, which varies between four and ten years. Intangible assets subject to amortization are tested for impairment when events or changes in circumstances indicate that their carrying value might not be recoverable. The carrying value of a long-lived asset is not recoverable if it is greater than the undiscounted cash flows that would likely be generated from the use and eventual disposal of the asset. An impairment charge equal to the amount by which the carrying value exceeds fair value would then be recognized in the Consolidated Statement of Income.

Obligations related to securities sold short

These financial liabilities represent the Bank's obligation to deliver securities it sold but did not own at the time of sale. Obligations related to securities sold short are recorded at fair value and presented as liabilities in the Consolidated Balance Sheet. Realized and unrealized gains and losses are recognized in *Other income* in the Consolidated Statement of Income.

Income taxes

The Bank provides for income taxes under the asset and liability method. It determines future income tax assets and liabilities based on the differences between the carrying values and the tax bases of assets and liabilities, in accordance with enacted or substantively enacted income tax laws and income tax rates that will apply on the date the differences will reverse. Future income tax assets represent tax benefits related to deductions the Bank may claim to reduce its taxable income in future years. A valuation allowance is established, if necessary, to reduce the future income tax asset to an amount that is more likely than not to be realized. No future income tax expense is recorded for the portion of retained earnings of foreign subsidiaries that is permanently reinvested.

Derivative financial instruments

In the normal course of business, the Bank uses derivative financial instruments to accommodate the needs of its clients, enable it to generate income from its trading activities, and manage its exposure to interest rate risk, foreign exchange risk and credit risk, as well as other market risks.

All derivative financial instruments are recorded at fair value in the Consolidated Balance Sheet. Derivative financial instruments with a positive fair value are included in assets, and derivative financial instruments with a negative fair value are included in liabilities in the Consolidated Balance Sheet.

Embedded derivative financial instruments

An embedded derivative financial instrument is a component of a financial instrument or another contract, the characteristics of which are similar to those of a derivative. Taken together, the financial instrument or contract is considered to be a hybrid instrument comprising a host contract and an embedded derivative financial instrument.

Embedded derivatives are bifurcated and accounted for separately if, and only if, the following three conditions are met: the economic characteristics and risks of the embedded derivative are not closely related to those of the host contract, the embedded derivative is a separate instrument that meets the definition of a derivative financial instrument, and the hybrid contract is not recorded at fair value.

Embedded derivative financial instruments are classified with the host contract on the Consolidated Balance Sheet and measured at their fair value. Realized and unrealized gains and losses are recorded in *Other income* in the Consolidated Statement of Income. For deposits whose return is based on portfolio management, realized and unrealized gains and losses are recognized in *Net interest income* in the Consolidated Statement of Income.

Held-for-trading derivative financial instruments

Derivative financial instruments are recognized at fair value, and the realized and unrealized gains and losses are recorded in *Other income* in the Consolidated Statement of Income.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

Derivative financial instruments designated as hedging items

Policy

The purpose of hedging transactions is to modify the Bank's exposure to one or more risks by creating an offset between changes in the fair value of, or the cash flows attributable to, the hedged item and the hedging item. Hedge accounting ensures that offsetting gains, losses, revenues and expenses are recognized in *Net income* in the same period or periods.

Documentation

At the inception of the hedging relationship, the Bank designates and formally documents all hedging relationships, detailing the risk management objective and the hedging strategy. The documentation identifies the specific asset, liability or cash flows being hedged, the related hedging item, the nature of the specific risk exposure or exposures being hedged, the intended term of the hedging relationship, the method for assessing the effectiveness of the hedging relationship, and the method for measuring the ineffectiveness of the hedging relationship. Both at the inception of the hedging relationship and throughout its term, the Bank ensures that the hedging relationship is effective and consistent with its originally documented risk management objective and strategy. When hedge accounting is appropriate, the hedging relationship is designated as a fair value hedge, a cash flow hedge or a foreign exchange hedge of a net investment in a self-sustaining foreign operation.

Fair value hedge

In a fair value hedge, the Bank mainly uses interest rate swaps to hedge changes in the fair value of a hedged item. The carrying value of the hedged item is adjusted based on the effective portion of the gains or losses attributable to the hedged risk, which are recognized in the Consolidated Statement of Income, as is the change in the fair value of the hedging item. The resulting ineffective portion is included in *Other income* in the Consolidated Statement of Income.

Hedge accounting is discontinued prospectively if the hedging relationship no longer qualifies as an effective hedge or if the hedging item is settled. The hedged item is no longer adjusted to reflect changes in fair value. Amounts previously recorded as cumulative adjustments with respect to the effective portion of gains and losses attributable to the hedged risk are amortized using the effective interest rate method and recognized in the Consolidated Statement of Income over the remaining useful life of the hedged item. Hedge accounting is also discontinued if the hedged item is sold or terminated before maturity. In such a situation, the cumulative adjustments with respect to the effective portion of gains and losses attributable to the hedged risk are immediately recorded in the Consolidated Statement of Income.

Cash flow hedge

In a cash flow hedge, the Bank mainly uses interest rate swaps to hedge exposure of the future cash flows related to a floating rate financial asset or liability. The Bank also uses total return swaps to hedge the risk of changes in future cash flows related to the Restricted Stock Unit (RSU) Plan. Some of these swaps are designated as part of a cash flow hedge against a portion of the unrecognized obligation of the RSU Plan. The effective portion of changes in fair value of the hedging item is recorded in *Accumulated other comprehensive income* and the ineffective portion in *Other income* in the Consolidated Statement of Income.

The amounts recorded in *Accumulated other comprehensive income* are reclassified to the Consolidated Statement of Income in the period or periods during which the cash flows of the hedged item affect the Consolidated Statement of Income.

When the derivative financial instrument no longer satisfies the conditions of effective hedging, hedge accounting is discontinued prospectively. The amounts previously recorded in *Accumulated other comprehensive income* are reclassified to the Consolidated Statement of Income in the period or periods during which the cash flows of the hedged item affect the Consolidated Statement of Income.

Hedge of a net investment in a self-sustaining foreign operation

Derivative and non-derivative financial instruments are used to hedge the foreign exchange risk related to investments made in self-sustaining foreign operations whose activities are denominated in a currency other than the Canadian dollar. The effective portion of the gains and losses on the hedging item is recorded in *Accumulated other comprehensive income* and the ineffective portion in *Other income* in the Consolidated Statement of Income.

Offsetting of financial assets and liabilities

Financial assets and liabilities are offset and the net amount is presented in the Consolidated Balance Sheet when the Bank has a legally enforceable right to set off the recognized amounts and intends to settle on a net basis or to realize the asset and settle the liability simultaneously.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

Guarantees

CICA Accounting Guideline No. 14, *Disclosure of Guarantees* (AcG-14) defines a guarantee as a contract (including an indemnity) that contingently requires the guarantor to make payments (in cash, financial instruments, other assets, shares of the guarantor, or provision of services) to the beneficiary due to (a) changes in an interest rate, security or commodity price, foreign exchange rate, index or other variable, including the occurrence or non-occurrence of a specified event that is related to an asset, a liability or an equity security of the beneficiary of the guarantee, (b) failure of a third party to perform under a contractual agreement, or (c) failure of a third party to pay its indebtedness when due.

Liabilities are recorded for the fair value of the obligation assumed at the inception of guarantees that satisfy the definition in AcG-14. No subsequent remeasurement at fair value is required, unless the financial guarantee is considered a derivative financial instrument.

Insurance revenues and expenses

Premiums less claims and changes in actuarial liabilities are recognized in *Other income* in the Consolidated Statement of Income.

Assets under administration and assets under management

The Bank administers and manages assets that are owned by clients but that are not recorded in the Consolidated Balance Sheet. Asset management fees are earned for providing investment and mutual fund management services. Asset administration fees are earned for providing trust, estate administration and custodial services. These fees are recognized in *Other income* in the Consolidated Statement of Income as the services are provided.

Employee future benefits

The Bank offers defined benefit pension plans that cover substantially all salaried employees. These defined benefit plans are funded pension plans. The Bank also offers its employees certain post-retirement and post-employment benefits, compensated leave and termination benefits (non-pension employee benefits) that are generally not funded. These benefits include healthcare, life insurance and dental benefits. Employees eligible for post-retirement benefits are those who retire at certain retirement ages. Employees eligible for post-employment benefits are those on long-term disability or maternity leave.

Actuarial valuations are made periodically to determine the present value of plan obligations. The actuarial valuation of accrued pension benefit obligations and of the accrued post-retirement benefit obligations is based on the projected benefit method prorated on services using the most likely assumptions according to Management regarding future salary levels, cost escalation, retirement age and other actuarial factors. The accrued benefit obligation is valued using market rates as at the measurement date. The assumption regarding the discount rate is determined using a yield curve for high-quality corporate bonds. With regard to the expected long-term returns on plan assets used to calculate pension expense, most of the fixed-income securities in the plans are measured using fair value, while equity securities and other assets are measured using a market-related value. This value is based on the recognition of changes in the fair value of assets over a three-year period.

The cost of pension and other post-retirement benefits earned by employees is established by calculating the sum of the following: the current period accrued benefit cost; the notional interest on the accrued benefit obligation; the expected long-term return on plan assets, based on the fair value or a market-related value; the amortization of net actuarial gains and losses; and the amortization of past service costs. The cumulative excess of pension plan contributions over the amounts recorded as expenses is recognized in *Other assets* of the Consolidated Balance Sheet, while the cumulative cost of post-retirement benefits, net of disbursements, is recognized in *Other liabilities* of the Consolidated Balance Sheet.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

Past service costs arising from amendments to the plans are amortized on a straight-line basis over the average remaining service period of active employees on the date of the amendments. The portion of the net actuarial gain or loss which exceeds 10% of either the accrued benefit obligation or the fair value of plan assets (market-related value for certain assets), whichever is higher, is amortized over the average remaining service period of active employees. This average remaining service period varies from 8 to 12 years, depending on the plan. When the restructuring of an employee benefit plan gives rise to both a curtailment and a settlement of obligations, the curtailment is accounted for before the settlement.

Stock-based compensation plans

The Bank has several stock-based compensation plans: the Stock Option Plan, the Stock Appreciation Rights (SAR) Plan, the Deferred Stock Unit (DSU) Plan, the Restricted Stock Unit (RSU) Plan, the Performance Stock Unit Plan (PSU), the Deferred Compensation Plan of National Bank Financial, and the Employee Share Ownership Plan.

The Bank has used the fair value based method to account for stock options awarded under its stock option plan since November 1, 2002. The fair value of the stock options is estimated on the award date using the discrete dividend Black-Scholes model. This cost is recognized on a straight-line basis over the vesting period, i.e., four years, as an increase in *Salaries and staff benefits* and *Contributed surplus*. When the options are exercised, the *Contributed surplus* amount is credited to *Shareholders' equity – Common shares* in the Consolidated Balance Sheet. The proceeds received from the employees when these options are exercised are also credited to *Shareholders' equity – Common shares* in the Consolidated Balance Sheet.

SARs are recorded at intrinsic value by measuring, on an ongoing basis and until they are exercised, the excess of the market price of the Bank's common stock over the exercise price of the right. The obligation, which results from the variation in the stock's market price, is recognized in income gradually over the vesting period of four years, and the corresponding amount is included in *Other liabilities* in the Consolidated Balance Sheet. When the vesting period expires and until the SARs are exercised, the change in the obligation attributable to variations in the stock price is recognized in *Salaries and staff benefits* in the Consolidated Statement of Income for the period in which the variations occur. When a SAR is exercised, the Bank makes a cash payment equal to the increase in the stock price since the date of the award.

The obligation that results from the award of a DSU, a RSU and a PSU is generally recognized in income gradually over the vesting period, and the corresponding amount is included in *Other liabilities* in the Consolidated Balance Sheet. For the DSU and RSU plans, the change in the obligation attributable to variations in the stock price and dividends paid on common shares for these plans is recognized in *Salaries and staff benefits* in the Consolidated Statement of Income for the period in which the variations occur. On the redemption date, the Bank makes a cash payment equal to the value of the common shares on that date. For the PSU Plan, the change in the obligation attributable to variations in the stock price, adjusted upward or downward depending on the relative result of the performance criteria, and the change in the obligation attributable to dividends paid on the common shares of the plan, are recognized in *Salaries and staff benefits* in the Consolidated Statement of Income for the period in which the variations occur. On the redemption date, the Bank makes a cash payment equal to the value of the common shares on that date, adjusted upward or downward according to the performance criteria. This is based on the total shareholder return (TSR) achieved by the Bank compared to that of the S&P/TSX Banks Sub-index.

Compensation costs related to awards granted to employees eligible to retire at the award date are immediately recognized on the award date. Compensation costs related to awards granted to employees who will become eligible to retire during the vesting period are recognized over the period from the award date to the date the employee becomes eligible to retire.

For all of these plans, cancellations and forfeitures are recognized as they occur.

The Bank uses derivative financial instruments to hedge the risks associated with some of these plans. The compensation expense for these plans, net of related hedges, is recognized in the Consolidated Statement of Income.

The Bank's contributions to the Employee Share Ownership Plan are expensed as incurred.

Comparative figures

Certain comparative figures from the previous year have been reclassified to conform to the presentation adopted in fiscal 2010.

NOTE 2

FUTURE ACCOUNTING POLICY CHANGES

Conversion to International Financial Reporting Standards (IFRS)

In February 2008, the Canadian Accounting Standards Board confirmed that all publicly accountable enterprises would be required to report under IFRS for fiscal years beginning on or after January 1, 2011. The Bank will apply IFRS commencing November 1, 2011. It will present its consolidated financial statements for the quarter ending January 31, 2012 in accordance with IFRS and will present comparative figures in accordance with IFRS for fiscal 2011, including an opening consolidated balance sheet as at November 1, 2010.

To prepare for the IFRS conversion, the Bank has established an enterprise-wide project, formed a dedicated project team and put in place a formal governance structure. It has developed a detailed project plan, assessed the resource requirements for its implementation, and continued training staff, senior management, and Board members. To date, the project is proceeding according to plan, and operationalization of the IFRS transition has begun.

First-time adoption of IFRS

Adoption of IFRS will require the Bank to follow the recommendations of IFRS 1, *First-time Adoption of International Financial Reporting Standards*. IFRS 1 generally prescribes that entities must retrospectively apply all IFRS standards upon transition, which, for the Bank, is November 1, 2010. When a standard is applied retrospectively, the opening consolidated balance sheet will be presented as though IFRS had always been applied, and the differences between Canadian GAAP and IFRS will be reflected in the IFRS opening retained earnings. However, IFRS 1 also provides mandatory exceptions to the retrospective application of certain IFRS standards and permits optional exemptions to this requirement for other IFRS standards. For the Bank, the main optional exemptions relate to (i) employee benefits, (ii) financial instrument designation, (iii) translation differences and (iv) business combinations. Applying certain exemptions will also affect the opening retained earnings under IFRS and could impact the results of post-IFRS-transition periods. A summary of the main optional exemptions is presented below.

Employee benefits

With respect to the actuarial gains and losses related to employee benefits, the Bank will have two options when it implements IFRS: either to recognize all unamortized gains and losses as at November 1, 2010 in retained earnings, or to calculate the charge from the time the Bank's plans were implemented as if the charge had always been calculated under the IFRS requirements on employee benefits. The Bank is planning to apply the first option.

Financial instrument designation

IFRS 1 offers an option whereby entities may, at the transition date, irrevocably designate any financial instrument as held-for-trading provided that certain criteria are met on that date. The Bank intends to use this option.

Translation differences

Under IFRS 1, cumulative currency translation differences can be reclassified to retained earnings. The Bank is planning to apply this optional exemption.

Business combinations

IFRS 1 permits prospective application of the standard on business combinations. The Bank is planning to apply this optional exemption so as to not restate business acquisitions completed before the transition date.

The Bank is still in the process of analyzing most of the IFRS 1 exemptions and has not made final decisions with respect to these exemptions. In March 2010, OSFI issued an advisory entitled *Conversion to International Financial Reporting Standards (IFRSs) by Federally Regulated Entities (FREs)*. OSFI is providing banks with the possibility to phase in, over five quarters, most of the negative impacts that conversion to IFRS will have on retained earnings for the purposes of calculating regulatory capital.

Main differences between Canadian GAAP and IFRS

The Bank has already identified the major differences between current Canadian GAAP and IFRS that will require adjustments to the opening balance sheet and retained earnings upon transition. The current standards likely to have a significant impact on the Bank's consolidated financial statements include the standards on (i) financial instrument derecognition, (ii) consolidation, (iii) employee benefits, (iv) impairment of available-for-sale securities, and (v) business combinations. A summary of the main differences is presented below.

NOTE 2 FUTURE ACCOUNTING POLICY CHANGES (cont.)

Financial instrument derecognition

The current criteria for financial asset derecognition under IFRS differ significantly from those under Canadian GAAP. Currently, under Canadian GAAP, the Bank derecognizes financial assets using a model based on control and the legal form. Under IFRS, derecognition is subject to more restrictive criteria, which are largely based on the notion of the transfer of substantially all of the risks and rewards related to ownership of the transferred assets. The Bank will retrospectively apply the derecognition requirements and expects that several financial asset transfers eligible for derecognition under Canadian GAAP will no longer qualify under IFRS. For instance, the Bank does not expect insured mortgage loans securitized under the Canada Mortgage Bond (CMB) Program to qualify for derecognition under IFRS. These mortgage loans will therefore be presented in the opening IFRS consolidated balance sheet as at November 1, 2010, thereby increasing total assets and liabilities. Also, because these are financing transactions, the Bank will no longer realize a securitization gain on the sale of mortgage loans under the CMB Program. On the transition date, November 1, 2010, the opening balance of retained earnings under IFRS will reflect the impact of recognizing past transactions as financing transactions instead of sale transactions. Also, in its notice published last March, OSFI stated that insured mortgage loans securitized before March 31, 2010 under the CMB Program will have no impact on the financial leverage ratio.

Consolidation

Canadian GAAP requires the consolidation of a variable interest entity (VIE) by its primary beneficiary, namely, the party that absorbs the majority of the entity's expected losses, receives the majority of the entity's expected residual returns, or both. Furthermore, Canadian GAAP provides an exemption for the consolidation of qualifying special purpose entities, eligible under certain conditions, that does not exist in IFRS. Under IFRS, the consolidation of special purpose entities is required based on the application of the principle of control. The Bank may need to consolidate new special purpose entities that were not consolidated prior to the Bank's IFRS transition date. Consolidation of these new entities could increase the assets and liabilities as well as non-controlling interests on the Bank's Consolidated Balance Sheet.

Employee benefits

The Bank offers defined benefit pension plans that cover substantially all salaried employees. Under Canadian GAAP, past service cost is amortized over the average remaining service life of employees, whereas under IFRS standards, the vested past service cost is recognized immediately in the Statement of Income. Following the transition, the Bank will need to choose either to recognize the actuarial gains and losses immediately in the Consolidated Statement of Income or the Consolidated Statement of Comprehensive Income or to continue to amortize actuarial gains and losses using the corridor approach (the method currently used under Canadian GAAP).

Impairment – Available-for-sale securities

Under IFRS, a decline in value is recognized in the Statement of Income when there is objective evidence of impairment. Under Canadian GAAP, an entity must also determine whether there is objective evidence of impairment, but unlike IFRS, impairment is recognized only if it is considered other than temporary. Impairment will be recognized more quickly in IFRS.

Business combinations

There are several differences between IFRS and Canadian GAAP related to the accounting for business combinations. The main items impacted include acquisition costs and restructuring costs, non-controlling interest, contingent consideration, and valuation of consideration paid in shares. Under Canadian GAAP, acquisition costs and certain restructuring costs are capitalized in goodwill, whereas under IFRS, they are expensed as incurred. For business combinations under Canadian GAAP, non-controlling interest is calculated based on the carrying value of the acquired company, and any contingent consideration is recognized only under certain circumstances, whereas under IFRS, these two items are measured at fair value at the time of the business combination. Under Canadian GAAP, shares issued as consideration are measured at their market price over a reasonable period of time (i.e., a few days) before and after the acquisition is announced, whereas under IFRS, the issued shares are measured at their market price on the acquisition date. These differences will have an impact on the purchase price allocation and on the amount of goodwill recognized in the Consolidated Balance Sheet.

Latest IFRS and regulatory developments

The International Accounting Standards Board (IASB) continues to propose changes to IFRS. In fiscal 2010, the IASB published a new standard on the classification and measurement of financial assets and financial liabilities, but these changes will not have to be adopted until after the transition date. In addition, other key standards affecting financial instruments will likely be amended, in particular the impairment of financial assets, hedge accounting, and the offsetting of assets and liabilities. Other major standards are also being revised, including those applicable to employee benefits, consolidation, income taxes and financial statement presentation. The Bank will probably not be required to apply these changes until after the transition date. The Bank is closely monitoring the changes made to these standards and the OSFI regulations and makes any required adjustments to its plan.

The standards in effect at the transition date, the economic environment at that time, the consolidated balance sheet amounts at that time, and the various accounting policy choices yet to be selected are some of the factors that will influence the impact of IFRS on the Bank. In the periods preceding the first fiscal year in which IFRS will be adopted, the impacts of transitioning to IFRS on the Bank's consolidated financial statements will be disclosed as they become known.

NOTE 3

CARRYING VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES BY CATEGORY

Financial assets and financial liabilities are recognized in the Consolidated Balance Sheet at fair value, cost or amortized cost according to the categories determined by the accounting framework for financial instruments. The carrying values for each category of financial asset and liability are presented in the table below.

As at October 31	2010						
	Financial instruments required to be classified as held-for-trading	Financial instruments designated as held-for-trading	Available-for-sale	Loans and receivables	Financial liabilities at cost or amortized cost	Derivative financial instruments designated as cash flow hedges	Derivative financial instruments designated as fair value hedges
Financial assets							
Cash	261	—	—	—	—	—	—
Deposits with financial institutions	—	—	—	2,013	—	—	—
Securities							
Available-for-sale	—	—	10,997	—	—	—	—
Held-for-trading	42,124	1,147	—	—	—	—	—
Securities purchased under reverse repurchase agreements	—	84	—	10,794	—	—	—
Loans	—	—	—	57,188 ⁽¹⁾	—	—	—
Other assets							
Customers' liability under acceptances	—	—	—	5,946	—	—	—
Fair value of derivative financial instruments	7,309	—	—	—	—	472	339
Amounts due from clients, dealers and brokers	—	—	—	2,909	—	—	—
Other	—	—	—	352	—	—	—
Total financial assets	49,694	1,231	10,997	79,202	—	472	339
Financial liabilities							
Deposits							
Personal	—	—	—	—	34,112	—	—
Business and government	—	627	—	—	41,358 ⁽¹⁾	—	—
Deposit-taking institutions	—	—	—	—	5,463	—	—
Deposit from NBC Capital Trust	—	—	—	—	225	—	—
Other liabilities							
Acceptances	—	—	—	—	5,946	—	—
Obligations related to securities sold short	18,292	—	—	—	—	—	—
Securities sold under repurchase agreements	—	—	—	—	12,513	—	—
Fair value of derivative financial instruments	6,418	—	—	—	—	19	194
Amounts due to clients, dealers and brokers	—	—	—	—	3,131	—	—
Other	—	—	—	—	4,992	—	—
Subordinated debentures	—	—	—	—	2,033	—	—
Total financial liabilities	24,710	627	—	—	109,773	19	194

(1) Including embedded derivative financial instruments.

NOTE 3 CARRYING VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES BY CATEGORY (cont.)

As at October 31	2009						
	Financial instruments required to be classified as held-for-trading	Financial instruments designated as held-for-trading	Available-for-sale	Loans and receivables	Financial liabilities at cost or amortized cost	Derivative financial instruments designated as cash flow hedges	Derivative financial instruments designated as fair value hedges
Financial assets							
Cash	296	—	—	—	—	—	—
Deposits with financial institutions	—	—	—	1,932	—	—	—
Securities							
Available-for-sale	—	—	13,281	—	—	—	—
Held-for-trading	33,041	3,911	—	—	—	—	—
Securities purchased under reverse repurchase agreements	—	—	—	7,637	—	—	—
Loans	—	—	—	52,637 ⁽¹⁾	—	—	—
Other assets							
Customers' liability under acceptances	—	—	—	5,733	—	—	—
Fair value of derivative financial instruments	6,798	—	—	—	—	449	269
Amounts due from clients, dealers and brokers	—	—	—	2,578	—	—	—
Other	—	—	—	379	—	—	—
Total financial assets	40,135	3,911	13,281	70,896	—	449	269
Financial liabilities							
Deposits							
Personal	—	—	—	—	34,609	—	—
Business and government	—	662	—	—	36,036 ⁽¹⁾	—	—
Deposit-taking institutions	—	—	—	—	3,638	—	—
Deposit from NBC Capital Trust	—	—	—	—	225	—	—
Other liabilities							
Acceptances	—	—	—	—	5,733	—	—
Obligations related to securities sold short	13,221	—	—	—	—	—	—
Securities sold under repurchase agreements	—	2,667	—	—	10,069	—	—
Fair value of derivative financial instruments	5,859	—	—	—	—	53	35
Amounts due to clients, dealers and brokers	—	—	—	—	3,017	—	—
Other	—	—	—	—	5,004	—	—
Subordinated debentures	—	—	—	—	2,017	—	—
Total financial liabilities	19,080	3,329	—	—	100,348	53	35

NOTE 4

FAIR VALUE OF FINANCIAL INSTRUMENTS

a) Establishing fair value

The Bank has policies governing the process for determining fair value. These policies are documented and periodically reviewed by the Risk Management Group. All valuation models are validated, and controls have been implemented to ensure that they are applied.

As judgment is used in applying a large number of acceptable valuation techniques and estimates to calculate fair value, fair values are not necessarily comparable among financial institutions. The estimated fair value reflects market conditions on a given date and, consequently, may not be indicative of future fair value.

When a financial instrument is initially recognized, its fair value is the amount of consideration for which the financial instrument would be exchanged in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, i.e., the fair value of the consideration received or paid. In certain circumstances, the initial fair value may be based on other observable current market transactions for the same instrument, without modification or repackaging, or based on a valuation technique whose variables include only observable market inputs. When the Bank uses a valuation technique based on observable market inputs to determine the initial fair value, or when the risks associated with the derivative contract are fully offset by other contracts entered into with third parties, the difference between the transaction price and the initial estimated fair value is recognized in the Consolidated Statement of Income. When the Bank uses a valuation technique based on significant unobservable market inputs, the difference between the fair value of the consideration received or paid and the amount determined using the valuation technique is deferred in the Consolidated Balance Sheet. The amount of the deferred gain or loss is recognized over the term of the financial instrument using the effective interest rate method. The unamortized balance is immediately recognized in net income when (i) observable market inputs can be obtained and support the fair value of the transaction, (ii) the risks associated with the initial contract are substantially offset by other contracts entered into with third parties, (iii) the gain or loss is realized through a cash receipt or payment, or (iv) the transaction matures or is cancelled before maturity.

When financial instruments are to be subsequently remeasured, quoted market prices in an active market provide the best indication of fair value, and when such prices are available, the Bank uses them to measure the financial instruments. A financial instrument is considered to be quoted in an active market when quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency and those prices reflect actual market transactions on an arm's length basis. The fair value of a financial asset traded in an active market generally reflects the bid price and, that of a financial liability traded in an active market, the ask price. If the market for a financial instrument is not active, the Bank establishes fair value using a valuation technique that primarily makes use of observable market inputs. Such valuation techniques include using available information concerning recent market transactions, reference to the current fair value of a comparable financial instrument, discounted cash flow analysis, option pricing models, and all other valuation techniques commonly used by market participants where it has been demonstrated that the technique provides reliable estimates.

In cases where the fair value is established using valuation models, the Bank makes assumptions about the amount, the timing of estimated future cash flows and the discount rates used. These assumptions are based primarily on observable market inputs such as interest rate yield curves, foreign exchange rates, credit curves as well as price and rate volatility factors. When one or more significant inputs are not observable in the markets, fair value is established primarily on the basis of internal estimates and data, taking into account the valuation policies in effect at the Bank, the economic environment, the specific characteristics of the financial asset or liability and other relevant factors. In certain specific cases, the Bank makes adjustments to the fair value to reflect the uncertainties in determining the fair value of financial instruments. These adjustments may stem from various factors such as the choice of valuation technique, the availability of observable market inputs, or assumptions used in the valuation techniques. The Bank may take market liquidity risk into account in determining the fair value of financial instruments not quoted in an active market when it believes that such instruments could be disposed of for a consideration below the fair value otherwise determined, due to a lack of market liquidity or an insufficient volume of transactions in a given market.

NOTE 4 FAIR VALUE OF FINANCIAL INSTRUMENTS (cont.)

The following table presents the carrying values and estimated fair values of financial assets and liabilities.

As at October 31	2010		2009	
	Carrying value	Fair value	Carrying value	Fair value
Financial assets				
Cash	261	261	296	296
Deposits with financial institutions	2,013	2,013	1,932	1,932
Securities				
Available-for-sale	10,997	11,010	13,281	13,320
Held-for-trading	43,271	43,271	36,952	36,952
Securities purchased under reverse repurchase agreements	10,878	10,708	7,637	7,514
Loans	57,188	56,617	52,637	51,795
Other assets				
Customers' liability under acceptances	5,946	5,946	5,733	5,733
Fair value of derivative financial instruments	8,120	8,120	7,516	7,516
Amounts due from clients, dealers and brokers	2,909	2,909	2,578	2,578
Other	352	352	379	379
Total financial assets	141,935	141,207	128,941	128,015
Financial liabilities				
Deposits	81,785	81,021	75,170	74,089
Other liabilities				
Acceptances	5,946	5,946	5,733	5,733
Obligations related to securities sold short	18,292	18,292	13,221	13,221
Securities sold under repurchase agreements	12,513	12,616	12,736	12,915
Fair value of derivative financial instruments	6,631	6,631	5,947	5,947
Amounts due to clients, dealers and brokers	3,131	3,131	3,017	3,017
Other	4,992	4,992	5,004	5,004
Subordinated debentures	2,033	1,993	2,017	1,981
Total financial liabilities	135,323	134,622	122,845	121,907

Valuation methods and assumptions

Financial instruments whose fair value is equal to their carrying value

The carrying value of certain financial assets and financial liabilities corresponds to a reasonable approximation of fair value. The Bank considers that the carrying value of cash; deposits with financial institutions; customers' liability under acceptances and acceptances; amounts due from and to clients, dealers and brokers; as well as certain other assets and liabilities, corresponds to the fair value.

Held-for-trading securities and obligations related to securities sold short

These financial instruments are presented at fair value on the Consolidated Balance Sheet. Their fair values are based on quoted market prices in an active market or, where quoted market prices in an active market are not readily available, quoted market prices of securities that are substantially the same. If such prices are not available, fair value is determined using a valuation technique that incorporates assumptions based primarily on observable market inputs, including current market prices and the contractual prices of the underlying instruments, the time value of money, interest rate yield curves and currency rates.

When one or more significant inputs are not observable in the markets, fair value is established primarily on the basis of estimates and data obtained internally, taking into account valuation policies in effect at the Bank, economic conditions, the specific characteristics of the financial asset or liability and other relevant factors.

Information about the fair value determination of the restructured notes of the master asset vehicle conduits, designated as held-for-trading, is provided in Note 9.

NOTE 4 FAIR VALUE OF FINANCIAL INSTRUMENTS (cont.)

Available-for-sale securities

These financial assets are presented on the Consolidated Balance Sheet at fair value, except for investments in equity securities that do not have a quoted market price in an active market, which are presented at cost. For additional information, see Note 8. For securities presented at fair value, quoted market prices in an active market are used. Where quoted market prices in an active market are not readily available, fair value is estimated using market prices of securities that are substantially the same. If such prices are not available, fair value is determined using valuation techniques that incorporate assumptions based on observable market inputs, including current market prices and the contractual prices of the underlying instruments, the time value of money, interest rate yield curves and currency rates.

The fair value of retained interests is determined by discounting expected future cash flows. The key assumptions used to measure the fair value of retained interests are weighted average term, expected credit losses, prepayment rates, anticipated excess spread (net of expected credit losses) and the discount rate based on the risks incurred.

Information about the fair value determination of the restructured notes of the master asset vehicle conduits, classified as available-for-sale, are described in Note 9.

Derivative financial instruments

The fair value of derivative financial instruments is based on quoted prices in an active market, where available. Otherwise, fair value is determined using valuation models that incorporate assumptions based primarily on inputs observed in external markets, such as current market prices and the contractual prices of the underlying instruments, the time value of money, interest rate yield curves, credit curves, currency rates as well as price and rate volatility factors. When one or more significant inputs are not observable in the markets, the fair value is established primarily on the basis of internal estimates and data, taking into account valuation policies in effect at the Bank, the economic conditions, the specific characteristics of the financial asset or liability and other relevant factors. In establishing the fair value of derivative financial instruments, the Bank incorporates credit risk, taking into consideration the financial capacity of the counterparties to the contracts, the measurement of the current or future market value of the transactions as well as credit risk mitigation measures such as master netting arrangements and collateral agreements. The Bank also incorporates its own credit risk.

Loans and securities purchased under reverse repurchase agreements

The fair value of loans and securities purchased under reverse repurchase agreements is determined as at the balance sheet date by discounting expected future contractual cash flows, adjusted for prepayment options using market interest rates currently charged for similar new financial instruments.

Deposits and securities sold under repurchase agreements

The fair value of deposits and securities sold under repurchase agreements is determined as at the balance sheet date by discounting expected future contractual cash flows and using market interest rates currently offered for financial instruments with similar terms. The estimate of future cash flows takes into account early redemption options on deposits, if any.

Subordinated debentures

The fair value of subordinated debentures is based on quoted market prices in an active market. If such prices are not available, fair value is determined by discounting future contractual cash flows using market interest rates currently offered for similar financial instruments and that have the same term to maturity.

b) Fair value hierarchy

Financial instruments recorded at fair value on the Consolidated Balance Sheet are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

- Level 1 – valuation based on quoted prices (unadjusted) observed in active markets for identical assets or liabilities;
- Level 2 – valuation techniques based on inputs that are quoted prices of similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; inputs other than quoted prices used in a valuation model that are observable for that instrument; and inputs that are derived principally from or corroborated by observable market inputs by correlation or other means; and
- Level 3 – valuation techniques with significant unobservable market inputs.

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

NOTE 4 FAIR VALUE OF FINANCIAL INSTRUMENTS (cont.)

The following table presents the financial instruments recorded at fair value in the Consolidated Balance Sheet on a recurring basis, classified using the fair value hierarchy described on the previous page. For fiscal 2010, there were no significant transfers of financial instruments between Levels 1 and 2.

As at October 31				2010
	Level 1	Level 2	Level 3	Total financial assets/ liabilities at fair value
Financial assets				
Cash	261	–	–	261
Securities				
Available-for-sale	1,363	9,162	93	10,618
Held-for-trading	28,618	13,368	1,285	43,271
Securities purchased under reverse repurchase agreements	–	84	–	84
Loans	–	–	(110)	(110)
Other assets				
Fair value of derivative financial instruments	243	7,829	48	8,120
Total financial assets	30,485	30,443	1,316	62,244
Financial liabilities				
Deposits				
Business and government	–	771	38	809
Other liabilities				
Obligations related to securities sold short	12,675	5,617	–	18,292
Securities sold under repurchase agreements	–	–	–	–
Fair value of derivative financial instruments	302	6,315	14	6,631
Total financial liabilities	12,977	12,703	52	25,732

As at October 31				2009
	Level 1	Level 2	Level 3	Total financial assets/ liabilities at fair value
Financial assets				
Cash	296	–	–	296
Securities				
Available-for-sale	7,557	5,222	115	12,894
Held-for-trading	18,662	17,009	1,281	36,952
Loans	–	–	(138)	(138)
Other assets				
Fair value of derivative financial instruments	319	7,166	31	7,516
Total financial assets	26,834	29,397	1,289	57,520
Financial liabilities				
Deposits				
Business and government	–	683	20	703
Other liabilities				
Obligations related to securities sold short	9,449	3,772	–	13,221
Securities sold under repurchase agreements	–	2,667	–	2,667
Fair value of derivative financial instruments	351	5,563	33	5,947
Total financial liabilities	9,800	12,685	53	22,538

FAIR VALUE OF FINANCIAL INSTRUMENTS (cont.)

The categories of financial instruments whose fair values are classified in Level 3 consist mainly of the following:

- held-for-trading financial instruments: investments in the restructured notes of the master asset vehicle (MAV) conduits (for additional information, see Note 9), certain investments in asset-backed debt securities, investments in hedge funds for which there are certain restrictions on unit or security redemptions, as well as certain derivative financial instruments whose fair value is established using internal valuation models that are based on significant unobservable market inputs;
- available-for-sale securities: investments in the restructured notes of the MAV conduits, as well as certain retained rights to future excess interest on securitization transactions;
- embedded derivatives related to the credit facilities provided to clients holding restructured notes of the MAV conduits (for additional information, see Note 9) and included in the general allowance for loans and credit facilities secured by restructured notes of the MAV conduits (for additional information, see Note 5); and
- structured notes classified in business and government deposits and whose fair value is established using internal valuation models that are based on significant unobservable market inputs.

The Bank performs sensitivity analyses for fair value measurements classified in Level 3, substituting the unobservable inputs with one or more reasonably plausible alternative assumptions. Except for the investments in the restructured notes of the MAV conduits (for additional information, see Note 9), these sensitivity analyses result in a negligible change in the fair value of financial instruments classified in Level 3.

c) Changes in the fair value of financial instruments classified in Level 3

The table on the following page summarizes the changes in the fair value of financial instruments classified in Level 3 for the year ended October 31, 2010. The Bank classifies financial instruments in this level when the valuation technique is based on at least one significant input that is not observable in the markets or due to a lack of liquidity in certain markets. The valuation technique may also be based, in part, on observable market inputs. The gains and losses presented hereafter may therefore include changes in fair value based on observable and unobservable inputs.

The Bank may hedge the fair value of financial instruments classified in the various existing levels through inverse hedge positions. Gains and losses for financial instruments classified in Level 3 presented hereafter do not reflect the inverse gains and losses on financial instruments used for economic hedging purposes that may have been classified by the Bank in Level 1 or 2. In addition, the Bank may hedge the fair value of financial instruments classified in Level 3 using other financial instruments classified in Level 3. The effect of these hedges is not included in the net amount presented in the table on the following page.

d) Deferred unrealized gains and losses at inception

Financial instruments, for which the Bank uses a valuation technique based on unobservable significant market inputs, are recorded at inception at the transaction price, i.e., the fair value of the consideration received or paid. Since the fair value established at inception using the valuation technique may differ from the transaction price, the related gain or loss is deferred. As at October 31, 2010 and 2009, the deferred amount was negligible.

NOTE 4 FAIR VALUE OF FINANCIAL INSTRUMENTS (cont.)

Change in the fair value of financial instruments classified in Level 3

Year ended October 31	2010				
	Available- for-sale securities	Held-for- trading securities	Loans	Fair value of derivative financial instruments ⁽¹⁾	Business and government deposits
Fair value as at October 31, 2009	115	1,281	(138)	(2)	(20)
Total realized and unrealized gains (losses) included in <i>Net income</i> ⁽²⁾	95	(4)	—	31	—
Purchases, sales, settlements and other ⁽³⁾	(117)	(9)	28	5	—
Financial instruments transferred to or from Level 3 ⁽⁴⁾	—	17	—	—	(18)
Fair value as at October 31, 2010	93	1,285	(110)	34	(38)
Changes in unrealized gains (losses) included in income with respect to financial assets and financial liabilities held as at October 31, 2010 ⁽⁵⁾	—	(3)	—	30	—
Year ended October 31	2009				
	Available- for-sale securities	Held-for- trading securities	Loans	Fair value of derivative financial instruments ⁽¹⁾	Business and government deposits
Fair value as at November 1, 2008	1,567	93	(23)	(17)	(18)
Total realized and unrealized gains (losses) included in <i>Net income</i> ⁽⁶⁾	(95)	(33)	(115)	15	(2)
Purchases, sales, settlements and other ⁽⁷⁾	(1,357)	1,221	—	—	—
Fair value as at October 31, 2009	115	1,281	(138)	(2)	(20)
Changes in unrealized gains (losses) included in income with respect to financial assets and financial liabilities held as at October 31, 2009 ⁽⁸⁾	—	(30)	(115)	16	(2)

(1) The fair value of derivative financial instruments is presented on a net basis of assets and liabilities.

(2) The total amount of net gains included in *Other income* was \$122 million.

(3) Including an amount of \$91 million related to purchases and amounts of \$40 million, \$137 million and \$7 million related to sales, settlements and other net variances.

(4) During fiscal 2010, certain financial instruments were transferred from Level 2 to Level 3 once their fair values were no longer determined using valuation techniques based on significant observable market inputs or once there was a lack of market liquidity.

(5) The total amount of unrealized gains included in *Other income* was \$27 million.

(6) A net loss of \$115 million was included in *Other income*. A loss of \$115 million was included in *Provision for credit losses* and is part of the general allowance established for loans and credit facilities secured by restructured notes of the MAV conduits (for additional information, see Note 5).

(7) Including amounts of \$1,396 million and \$14 million related to purchases and other net variances, and an amount of \$1,546 million related to sales.

(8) Net loss of \$16 million included in *Other income* and a loss of \$115 million included in *Provision for credit losses*.

NOTE 5

MANAGEMENT OF THE RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS

The Bank views risk as an integral part of its development and the diversification of its activities and advocates a risk management approach consistent with its business expansion strategy. The purpose of sound risk management is to provide reasonable assurance that incurred risks do not exceed acceptable thresholds and that risk-taking contributes to the creation of shareholder value. For the Bank, this means striking a healthy balance between return and risk.

In the normal course of business, the Bank is primarily exposed to the risks described below.

Credit risk	Risk of a financial loss if an obligor does not fully honour its contractual commitments to the Bank. Obligors may be borrowers, issuers, counterparties or guarantors.
Market risk	Risk of a financial loss resulting from unfavourable changes in underlying market factors, namely, interest rates, foreign exchange rates, equity prices, commodity prices, credit risk and market volatility.
Liquidity risk	Risk that the Bank will be unable to honour daily cash commitments without resorting to costly and untimely measures.
Operational risk	Risk of loss resulting from an inadequacy or a failure ascribable to people, processes, technology or external events.
Regulatory risk	Risk related to the consequences of failing to meet compliance obligations, i.e., when the Bank or one of its employees fails to comply with relevant legislation in effect where the Bank carries on its operations, which could result in penalties, sanctions and substantial financial losses.
Reputational risk	Risk that the Bank's operations or practices will be negatively judged by the public, whether that judgment is with or without basis, thereby adversely affecting the perception, image or trademarks of the Bank, potentially resulting in litigation or loss of income.
Environmental risk	Risk of a loss or of injury to the Bank's reputation, arising from environmental concerns related to the Bank or its clients. Environmental risk is often associated with credit risk and operational risk.

Risk management framework

To achieve its risk management objectives, the Bank has a risk management framework that comprises the elements presented hereafter:

Risk management culture

The Bank and its management routinely promote a risk management culture through internal communications that advance a balanced model where business development initiatives are accompanied by a constant concern for sound risk management.

Governance structure

The governance structure at the Bank sets out the roles and responsibilities of all levels of the organization.

The Audit and Risk Management Committee (ARMC) of the Board of Directors (Board)

The ARMC approves risk management policies and sets risk tolerance limits. In addition to ensuring that the appropriate resources and processes are in place to properly and effectively manage risk on an ongoing basis, it examines and approves all significant aspects of risk assessment systems.

The Bank's Management

The Bank's Management promotes the risk management culture Bank-wide and manages the primary risks to which the Bank is exposed.

The Global Risk Committee

The Global Risk Committee defines the parameters of the policies that determine risk tolerance and the overall risk strategy, for the Bank and its subsidiaries as a whole, and sets limits as well as tolerance and intervention thresholds enabling the Bank to properly manage the main risks to which it is exposed. Specifically, the Committee approves and monitors all large credit facilities. The following committees report to the Global Risk Committee: the Market Risk Management Committee, the Operational Risk Management Committee, and the Asset/Liability Management Committee.

NOTE 5 MANAGEMENT OF THE RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS (cont.)

The Risk Management Group

This group proposes risk management policies and implements tools and models for identifying, measuring and monitoring risks. In addition to instituting and applying various independent risk review and approval procedures, this group also proposes risk limits that reflect the risk tolerance established by the ARMC and informs Management and the Board of significant risks.

The business units

The business units manage risks related to their operations within established limits and in accordance with risk management policies by identifying, analyzing and understanding the risks to which they are exposed and by implementing risk mitigation mechanisms.

Risk management policies

Risk management policies, along with the related guidelines and procedures, are the essential elements of the risk management framework. They describe how business units must manage risk and the approval process for risk decisions and, in particular, set the risk limits to be adhered to. These policies cover all the main risks defined in the Bank's risk management approach and are reviewed on a regular basis – in most cases, annually – to ensure that they are still relevant given changes in the markets and the business plans of the Bank's many business units. Other policies, standards and procedures complement the risk management policies and cover more specific aspects of management, such as business continuity and the launch of new products, initiatives or activities. These policies, standards and procedures generally apply across the Bank.

Credit risk management

Credit risk is the most significant risk facing the Bank in the normal course of business. The Bank is exposed to credit risk not only through its direct lending activities and transactions, but also through commitments to extend credit, letters of guarantee, letters of credit, over-the-counter derivatives trading, available-for-sale debt securities, securities purchased under reverse repurchase agreements, deposits with financial institutions, brokerage activities and transactions carrying a settlement risk for the Bank such as fund transfers to third parties via electronic payment systems.

A policy framework centralizes the governance of activities that generate credit risk for the Bank as a whole and is supplemented by a series of subordinate internal or sectoral policies and guidelines used to provide more thorough coverage of the given business lines or deal with specific management issues such as credit limits, collateral requirements and risk assessment.

Credit risk assessment of loans

Before a sound and prudent credit decision can be taken, the credit risk represented by the borrower or counterparty must be accurately assessed. This assessment is performed at the outset of the credit application process. Each application is analyzed and assigned one of 19 grades on a scale of 1 to 10 using a credit rating system developed by the Bank for all portfolios exposed to credit risk. As each grade corresponds to a borrower's or counterparty's probability of default, the credit risk can be determined for the Bank. The credit risk assessment method varies according to portfolio type.

The main parameters used in measuring the credit risk of loans outstanding and undrawn amounts are as follows:

- probability of default (PD), which is the probability that the obligor in question will default within one year;
- loss given default (LGD), which represents the magnitude of the expected loss from the obligor's default, expressed as a percentage of exposure at default; and
- exposure at default (EAD), which is the estimated amount potentially drawn at the time of the obligor's default.

Personal credit portfolios

This category comprises credit portfolios composed of residential mortgage loans, consumer loans and loans to some small businesses. The credit risk of these portfolios is measured using credit scoring models. The obligor's default risk rating for personal credit is determined using these models. The risk assessments also factor in the risk related to the product, for example, a line of credit compared to a term loan. Personal credit risk assessments are based on a group of borrowers with similar credit histories and behaviour profiles.

A risk analysis based on loan grouping in pools of homogeneous obligor profiles is used for the overall management of personal credit portfolios. This personal risk assessment approach, which has proven particularly effective for estimating loan defaults and losses, takes a number of factors into account, namely:

- behaviour scoring
- loan product characteristics
- collateral provided
- the length of time on the Bank's balance sheet
- loan status (active, delinquent or defaulted)

Loan pools are also established based on probability of default, loss given default and exposure at default, which are measured based on the characteristics of the obligor and the transaction itself. Loss given default is estimated based on transaction-specific factors including loan product characteristics, loan-to-value ratio and types of collateral. Under the Bank's default and facility risk rating policies, as well as the review and renewal policies and the risk quantification policy, the default risk ratings must be reviewed annually.

Business and government credit portfolios

This category comprises business (other than some small businesses, which are classified in personal credit portfolios), government and financial institution credit portfolios.

These credit portfolios are assigned a risk rating based on a detailed individual analysis of the financial and non-financial aspects of the borrower, including its financial health, sector of economic activity, competitive ability, access to capital and management quality. The Bank has risk-rating tools and models enabling it to specifically assess the risk represented by an obligor in relation to its industry and peers. The models used are adapted to the obligor's broad sector of activity. Models have been set up for seven sectors: business – commercial, large business, banks-brokerage, sovereign states, energy, real estate and agriculture.

This risk assessment method assigns a default risk rating to an obligor that reflects its credit quality. For each credit risk rating corresponds a probability of default (see table below). This credit quality classification enables the Bank to adequately differentiate its respective assessments of an obligor's ability to meet its contractual obligations. This kind of assessment must be done independently of external circumstances, particularly adverse economic or financial conditions likely to put stress on the business. Default risk ratings are assigned according to an assessment of the obligors' commercial and financial risks, based on a solvency review. Various risk quantification models, described below, are used to perform this assessment.

The business and government default risk rating scale used by the Bank is similar in some ways to the systems used by major external rating agencies. The Bank's scale has 19 grades. The table below groups these grades by major risk category and compares them with the ratings of two major rating agencies.

Internal default risk ratings – business

Ratings	Standard & Poor's	Moody's	Description ⁽¹⁾
1 – 2.5	AAA to A-	Aaa to A3	Excellent
3 – 4	BBB+ to BBB-	Baa1 to Baa3	Good
4.5 – 6	BB+ to B+	Ba1 to B1	Satisfactory
6.5 – 7.5	B to CCC+	B2 to Caa1	Special mention
8 – 8.5	CCC and CCC-	Caa2 and Caa3	Substandard
9 – 10	CC, C and D	Ca, C and D	Default

(1) Additional information is provided in the tables on page 118.

NOTE 5 MANAGEMENT OF THE RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS (cont.)

The Bank also uses individual assessment models to assign a risk rating to the credit facility based on the collateral and guarantees the obligor is able to provide and, in some cases, based on other factors.

The Bank consequently has a bi-dimensional risk rating system that, using internal and external historical data, establishes a default risk rating for each obligor, and models that assign a risk rating to the credit facility that is independent of the risk rating assigned to the obligor.

Credit-granting process

Credit-granting decisions are based first and foremost on the results of the risk assessment. In addition to the client's solvency, credit-granting decisions are also influenced by factors such as available collateral, transaction compliance with policies, standards and procedures, and the Bank's overall risk-adjusted return objective. Each credit-granting decision is made by authorities within the risk management teams and management who are independent of the business units and are at a reporting level commensurate with the size of the proposed credit transaction and the associated risk.

Decision-making authority is determined in compliance with the delegation of authority set out in the Credit Risk Management Policy. A person in a senior position in the organization approves credit facilities that are substantial or carry a higher risk for the Bank. The Bank's Global Risk Committee approves and monitors all substantial credit facilities. Credit applications that exceed management's latitudes are submitted to the Board for approval. The credit-granting process demands a high level of accountability from managers, who must proactively manage the credit portfolio.

Risk mitigation

The Bank also controls credit risk with various risk mitigation techniques. The most common method used to mitigate credit risk is to obtain quality collateral from counterparties. In the Bank's opinion, obtaining collateral cannot replace a rigorous assessment of a counterparty's ability to meet its obligations, but, beyond a certain risk threshold, it is an essential complement. Collateral is not required in all cases; it depends upon the level of risk presented by the borrower and the type of loan granted. However, if the level of risk to the Bank is considered high, the counterparty will likely be asked to pledge collateral. The legal validity of any collateral obtained and the Bank's ability to correctly measure the collateral's value on a regular basis are critical for this mechanism to play its proper role in risk mitigation. The Bank has established specific requirements in its internal policies with respect to the appropriate legal documentation and assessment for the kinds of collateral that business units may require in guarantee of the loans they grant to their counterparties. The categories of eligible collateral and the lending value of these assets have also been defined by the Bank. For the most part, they include the following asset categories: accounts receivable, inventory, machinery and equipment, rolling stock, real estate mortgages on residential, commercial and office buildings and on industrial facilities, as well as cash and marketable securities.

Obligations related to the trading of contracts on derivative financial instruments are frequently subject to credit risk mitigation measures. The first of these, and the most widely used, is the signing of *International Swaps & Derivatives Association, Inc. (ISDA)* Master Agreements with the appropriate counterparties. These agreements make it possible to apply full netting of the gross amounts of the market price assessments, when one of the contracting parties defaults on the agreement, for each of the transactions covered by the agreement and in force at the time of default. The amount of the final settlement is therefore the net balance of gains and losses on each transaction, which increases the likelihood of recovery when a counterparty defaults. The Bank's policies require signing an ISDA agreement with each counterparty trading derivative financial instruments with its traders. Under certain conditions, foreign exchange contracts are exempt from this rule, but the Bank prefers signing ISDA agreements as often as possible.

Another mechanism for reducing credit risk complements the ISDA Master Agreement in many cases and provides the Bank and its counterparty (or both parties, if need be) with the right to request collateral from the counterparty when the net balance of gains and losses on each transaction exceeds a threshold defined in the agreement. These agreements are known as *Credit Support Annex (CSAs)*.

NOTE 5 MANAGEMENT OF THE RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS (cont.)

Portfolio diversification and management

The Bank is exposed to credit risk not only through outstanding loans and undrawn amounts to a particular borrower, but also through the sectoral distribution of loans outstanding, undrawn amounts, and the exposure of its various credit portfolios to geographical, concentration and settlement risks.

The Bank's approach to controlling these diverse risks begins with optimizing diversification of its exposures. The management criteria set out in its internal policies and procedures include measures designed to maintain a healthy degree of diversification of credit risk in its portfolios. These instructions are mainly reflected in the application of various limits on the scope of its exposures: credit approval limits and country limits by hierarchical level; limits on counterparty credit concentration; and credit concentration limits by industry, country, region and type of financial instrument. Compliance with these limits is monitored through periodic reports submitted by Risk Management officers to the Board.

The criteria established for portfolio diversification and the specific limits set for economic, industrial or geographical sectors are based on the findings of sector-based studies and analyses conducted by economists and the Bank's Risk Management Group, and are approved by the Global Risk Committee. Continuous analyses are performed in order to anticipate problems with a sector or borrower before they materialize as defaulted payments.

Other risk mitigation methods

- *Credit derivative financial instruments*
To some extent, the Bank also reduces credit risk by using the protection provided by derivative financial instruments such as credit default swaps. When the Bank acquires credit protection, it pays a premium on the swap to the counterparty in exchange for the counterparty's commitment to pay in the event of default of the underlying entity or another event involving the counterparty and covered by the legal agreement. Since, like borrowers, providers of credit protection must receive a default risk rating, the Bank's internal policies set out all the criteria under which a counterparty may be judged eligible to mitigate the Bank's credit risk.
- *Loan syndication*
For loan syndication, the Bank has developed specific instructions on the appropriate objectives, responsibilities and documentation requirements.
- *Securitization*
Securitization is a means for transferring to a third party a portion of the credit risk incurred on loans originally granted by the Bank. A more detailed analysis of this activity is provided in Note 11.

Account follow-up and recovery

Credit granted and borrowers are monitored on an ongoing basis and in a manner commensurate with the related risk. Loan portfolio managers rely on an array of methods to conduct a particularly rigorous follow-up on problem loans. When loans continue to deteriorate and there is an increase in risk to the point where monitoring has to be increased, a group specialized in managing problem accounts steps in to maximize collection of the disbursed amounts and tailor strategies to these accounts.

In these cases, loan portfolio managers prepare and submit, to the concerned credit department, a detailed monitoring report each month to track the status of at-risk obligors and the corrective measures undertaken. The management of each credit department concerned performs follow-ups on the reports, and each quarter the Credit Monitoring Committee meets to review the action plans and monitoring reports of obligors that have disbursed loans or undrawn amounts of \$2 million or more. The authority to approve allowances for credit losses is attributed using limits delegated on the basis of hierarchical level under the credit risk management policy.

Detailed information on the recognition of impaired loans and allowances for credit risk are presented in Note 1.

NOTE 5 MANAGEMENT OF THE RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS (cont.)

Maximum credit risk exposure

The amounts shown in the table below represent the Bank's maximum exposure to credit risk as at the balance sheet date without taking into account any collateral held or any other credit enhancements.

As at October 31						2010
						Maximum exposure to credit risk under Basel asset categories ⁽¹⁾
	Drawn ⁽²⁾	Undrawn commitments ⁽³⁾	Repo-style transactions ⁽⁴⁾	OTC derivatives ⁽⁵⁾	Other off-balance sheet items ⁽⁶⁾	Total
Retail						
Residential mortgages	23,609	4,636	—	—	—	28,245
Qualifying revolving retail	2,562	2,655	—	—	—	5,217
Other retail	10,335	1,243	—	—	22	11,600
Total retail	36,506	8,534	—	—	22	45,062
Non-retail						
Corporate	21,986	9,416	1,468	—	1,878	34,748
Sovereign	10,181	2,753	8,921	13	86	21,954
Bank	3,248	45	38,801	182	303	42,579
Total non-retail	35,415	12,214	49,190	195	2,267	99,281
Trading portfolio	—	—	—	7,141	—	7,141
Securitization	1,239	—	—	—	2,054	3,293
Total – Credit risk	73,160	20,748	49,190	7,336	4,343	154,777
Standardized Approach	5,358	210	1,446	2,251	363	9,628
AI RB Approach	67,802	20,538	47,744	5,085	3,980	145,149
Total – Credit risk	73,160	20,748	49,190	7,336	4,343	154,777

As at October 31						2009
						Maximum exposure to credit risk under Basel asset categories ⁽¹⁾
	Drawn ⁽²⁾	Undrawn commitments ⁽³⁾	Repo-style transactions ⁽⁴⁾	OTC derivatives ⁽⁵⁾	Other off-balance sheet items ⁽⁶⁾	Total
Retail						
Residential mortgages	21,154	6,317	—	—	—	27,471
Other retail	11,334	4,808	—	—	—	16,142
Total retail	32,488	11,125	—	—	—	43,613
Non-retail						
Corporate	21,727	14,785	1,457	40	1,497	39,506
Sovereign	11,646	1,331	7,808	63	215	21,063
Bank	7,023	2,116	11,108	281	712	21,240
Total non-retail	40,396	18,232	20,373	384	2,424	81,809
Trading portfolio	—	—	—	6,343	—	6,343
Securitization	1,250	1,003	—	—	—	2,253
Total – Credit risk under the Standardized Approach	74,134	30,360	20,373	6,727	2,424	134,018

(1) Since November 1, 2009, the Bank has been applying the Advanced Internal Rating-Based approach for credit risk; prior to that date, it had been applying the Standardized Approach.

(2) The amounts drawn represent certain deposits with financial institutions, available-for-sale debt securities, gross loans, customers' liability under acceptances and other assets.

(3) Undrawn commitments represent unused portions of authorized credit facilities in the form of loans, acceptances, letters of guarantee and documentary letters of credit, excluding investment banking activities.

(4) Represent securities purchased under reverse repurchase agreements and sold under repurchase agreements.

(5) Represent forwards, futures, swaps and options.

(6) Letters of guarantee, documentary letters of credit, and securitized assets that represent the Bank's commitment to make payments in the event that a client cannot meet its financial obligations to third parties.

MANAGEMENT OF THE RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS (cont.)

Business and government loan portfolio subject to the Advanced Internal Rating-Based Approach

The table below presents the credit quality of the business and government loan portfolio subject to the Advanced Internal Rating-Based Approach, according to the internal rating risk categories assigned to borrowers.

				2010
				Exposure at default
	Drawn ⁽¹⁾	Undrawn commitments ⁽²⁾	Other exposures ⁽³⁾	Total
Excellent	14,207	4,353	31,243	49,803
Good	6,520	5,154	15,027	26,701
Satisfactory	8,453	2,134	3,495	14,082
Special mention	2,373	322	58	2,753
Substandard	208	32	14	254
Default	237	9	6	252
Total – Credit risk	31,998	12,004	49,843	93,845

(1) Amounts drawn represent certain deposits with financial institutions, available-for-sale debt securities, gross loans, customers' liability under acceptances and other assets.

(2) Undrawn commitments represent unused portions of authorized credit facilities in the form of loans, acceptances, letters of guarantee and documentary letters of credit, excluding investment banking activities.

(3) Other exposures represent securities purchased under reverse repurchase agreements and sold under repurchase agreements, forwards, futures, swaps and options and also include letters of guarantee, documentary letters of credit, and securitized assets that represent the Bank's commitment to make payments in the event a client cannot meet its financial obligations to third parties.

Personal loan portfolio subject to the Advanced Internal Rating-Based Approach

The table below presents the credit quality of the personal loan portfolio subject to the Advanced Internal Rating-Based Approach, according to the internal rating risk categories assigned to borrowers.

				2010
				Exposure at default
	Residential mortgages ⁽¹⁾	Qualifying revolving retail ⁽²⁾	Other retail ⁽³⁾	Total
Excellent	15,800	2,531	2,123	20,454
Good	7,624	1,090	2,784	11,498
Satisfactory	4,123	1,254	3,794	9,171
Special mention	343	264	698	1,305
Substandard	228	56	218	502
Default	71	22	98	191
Total – Credit risk	28,189	5,217	9,715	43,121

(1) Includes home equity lines of credit.

(2) Includes lines of credit and credit card receivables.

(3) Includes consumer loans, credit card receivables, certain SME loans, and other personal loans.

NOTE 5 MANAGEMENT OF THE RISKS ASSOCIATED WITH FINANCIAL

Allocation of gross and impaired loans by borrower category

	2010 ⁽¹⁾				
	As at October 31			Year ended October 31	
	Gross loans	Impaired loans	Specific allowances	Specific provisions for credit losses	Write-offs
Residential mortgage ⁽²⁾	23,609	31	5	(4)	1
Qualifying revolving retail ⁽³⁾	2,556	15	9	63	103
Other retail ⁽⁴⁾	10,207	53	22	31	57
Total – Retail	36,372	99	36	90	161
Agriculture	2,017	27	17	(6)	3
Mines, quarries and energy	728	4	2	6	2
Construction and real estate ⁽⁵⁾	2,738	41	14	1	14
Manufacturing	2,097	117	81	23	6
Wholesale and retail	2,549	15	15	4	4
Transportation	503	1	–	–	–
Communications	934	40	23	2	–
Financial institutions and insurance	3,557	1	–	–	–
Services	3,135	10	5	19	7
Government	432	–	–	–	–
Other	2,762	14	14	5	8
Total – Business and government	21,452	270	171	54	44
Total	57,824	369	207	144	205

(1) According to the Basel asset classes.

(2) Includes home equity lines of credit.

(3) Includes lines of credit and credit card receivables.

(4) Includes consumer loans, credit card receivables, certain SME loans, and other personal loans.

(5) Includes non-residential mortgages.

	2009				
	As at October 31			Year ended October 31	
	Gross loans	Impaired loans	Specific allowances	Specific provisions for credit losses	Write-offs
Residential mortgage	14,961	32	3	(4)	2
Personal ⁽¹⁾	18,313	52	23	98	160
Non-residential mortgage	1,318	14	4	(1)	2
Agriculture, fishing and trapping	1,911	55	25	10	7
Financial institution	3,022	2	2	2	–
Manufacturing	2,153	91	37	31	15
Construction and real estate	1,399	15	8	2	5
Transportation and communication	1,165	2	1	1	–
Mines, quarries and energy	1,109	4	1	3	7
Forestry	75	3	2	–	1
Government	1,262	–	–	–	–
Wholesale	585	9	6	5	1
Retail	1,534	38	26	7	2
Services	1,991	62	24	14	3
Other	2,479	28	22	11	3
Total – Business and government	20,003	323	158	85	46
Total	53,277	407	184	179	208

(1) Includes consumer loans, credit card receivables and other personal loans.

NOTE 5 MANAGEMENT OF THE RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS (cont.)

Residual contractual maturities of loans

As at October 31	2010 ⁽¹⁾				2009
	Less than 1 year	1 to 5 years	More than 5 years	Total	Total
Personal loans					
Residential mortgage	16,180	7,150	274	23,604	14,958
Qualifying revolving retail	2,547	–	–	2,547	–
Other retail	6,585	2,500	1,100	10,185	18,290
Total – Personal loans	25,312	9,650	1,374	36,336	33,248
Business and government loans					
Business	11,838	4,017	354	16,209	15,158
Sovereign	1,531	288	37	1,856	544
Bank	3,189	27	–	3,216	4,143
Total – Business and government loans	16,558	4,332	391	21,281	19,845
	41,870	13,982	1,765	57,617	53,093
Less: General allowance				429	456
Total				57,188	52,637

(1) According to the Basel asset classes.

Credit quality of loans

As at October 31	2010			
	Residential mortgage	Personal and credit card	Business and government ⁽¹⁾	Total
Neither past due ⁽²⁾ nor impaired	15,613	20,243	20,955	56,811
Past due ⁽²⁾ but not impaired	164	258	222	644
Impaired	29	48	292	369
	15,806	20,549	21,469	57,824
Less: Specific allowances	4	25	178	207
Subtotal	15,802	20,524	21,291	57,617
Less: General allowance⁽³⁾				429
Total				57,188
As at October 31	2009			
	Residential mortgage	Personal and credit card	Business and government ⁽¹⁾	Total
Neither past due ⁽²⁾ nor impaired	14,788	18,092	19,389	52,269
Past due ⁽²⁾ but not impaired	141	169	291	601
Impaired	32	52	323	407
	14,961	18,313	20,003	53,277
Less: Specific allowances	3	23	158	184
Subtotal	14,958	18,290	19,845	53,093
Less: General allowance⁽³⁾				456
Total				52,637

(1) Business credit portfolios are closely monitored and a monthly watchlist of problem commitments is produced. The watchlist is analyzed by the loan portfolio managers concerned, who must then submit a report to Credit Risk Management.

(2) A loan is considered to be past due when the counterparty has not made a payment the day of the contractual expiry date.

(3) The general allowance for credit risk was created taking into account the Bank's overall credit portfolio including an amount created for loans and credit facilities secured by the restructured notes of the MAV conduits.

NOTE 5 MANAGEMENT OF THE RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS (cont.)

Loans past due but not impaired

As at October 31	2010			2009		
	Residential mortgage	Personal and credit card	Business and government	Residential mortgage	Personal and credit card	Business and government
Past due but not impaired						
1 month late	72	94	96	53	54	105
2 months late	26	36	53	18	23	28
3 months late and more ⁽¹⁾	66	128	73	70	92	158
Total	164	258	222	141	169	291

(1) Includes fully secured loans for which, in the opinion of Management, there is reasonable assurance as to the ultimate collection of principal or interest. Credit card receivables are included in this category because they are written off only when payment is 180 days in arrears.

Impaired loans

As at October 31	2010			2009		
	Gross	Specific allowances	Net	Gross	Specific allowances	Net
Loans						
Residential mortgage	29	4	25	32	3	29
Personal and credit card	48	25	23	52	23	29
Business and government	292	178	114	323	158	165
Total	369	207	162	407	184	223

5 MANAGEMENT OF THE RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS (cont.)

Allowances for credit losses

Year ended October 31				2010
	Residential mortgage	Personal and credit card	Business and government	Total
Specific allowances at beginning	3	23	158	184
Provision for credit losses	(4)	94	54	144
Write-offs	(2)	(60)	(40)	(102)
Write-offs on credit cards	—	(103)	—	(103)
Recoveries	7	71	6	84
Specific allowances at end	4	25	178	207
General allowance at beginning ⁽¹⁾				456
Recoveries (write-offs), net ⁽²⁾				(27)
General allowance ⁽³⁾ at end				429
Allowances at end				636

Year ended October 31				2009
	Residential mortgage	Personal and credit card	Business and government	Total
Specific allowances at beginning	3	14	121	138
Provision for credit losses	(4)	98	85	179
Write-offs	(2)	(55)	(46)	(103)
Write-offs on credit cards	—	(105)	—	(105)
Recoveries	6	71	(2)	75
Specific allowances at end	3	23	158	184
General allowance at beginning ⁽⁴⁾				331
Provision for credit losses ⁽⁵⁾				126
Recoveries (write-offs), net				(1)
General allowance ⁽¹⁾ at end				456
Allowances at end				640

(1) The general allowance for credit risk was established taking into account the Bank's overall credit portfolio, except for an amount of \$148 million created for loans and credit facilities secured by restructured notes of the MAV conduits.

(2) The Bank took back restructured notes of the MAV conduits related to the credit facilities in an amount of \$63 million, to which an amount of \$27 million of the general allowance was applied.

(3) The general allowance for credit risk was established taking into account the Bank's overall credit portfolio, except for an amount of \$121 million created for loans and credit facilities secured by restructured notes of the MAV conduits.

(4) The general allowance for credit risk was established taking into account the Bank's overall credit portfolio, except for an amount of \$23 million created for loans secured by restructured notes of the MAV conduits.

(5) Provisions taken for credit facilities granted to clients holding restructured notes of the MAV conduits.

NOTE 5 MANAGEMENT OF THE RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS (cont.)

Market risk management

Market risk is intrinsically interlinked with participation in financial markets. Managing this risk is a core competency for the Bank in its trading, investing and asset/liability management activities.

Assessing market risk

An integrated internal framework is used to manage market risk, which is overseen by the Market Risk Management Committee. The Bank is adapting its market risk management and oversight framework based on recent regulatory changes, including new rules on measuring “value at risk” (VaR or exposure to risk) in crisis situations and assessing specific risk.

The Risk Management Group uses a variety of market risk measurement mechanisms to control and monitor exposure, the main one being the Value-at-Risk simulation model. VaR has the advantage of providing a uniform measurement of financial instrument-related market risks based on a single statistical confidence level and time horizon. It is the maximum value of simulated daily losses, in the portfolios held, measured at a 99% confidence level, which means that actual losses may be likely to exceed the value only one day out of 100. The holding period, i.e., the expected timeframe for liquidating a position, is one day for trading portfolios. VaR is calculated on a daily basis both for major classes of financial instruments (including derivative financial instruments) and all portfolios of the Financial Markets segment of the Bank. By calculating this value, the Bank seeks to ensure that trading and investment decisions do not entail risks in excess of preset limits. The VaR calculation model is based on a historical simulation methodology using two years of data.

Outstanding VaR is monitored daily in relation to established limits according to type of market risk, portfolio, business unit, and main category of activity, i.e., trading, investment and asset/liability management. Furthermore, investment activities, i.e., available-for-sale securities, are governed by an investment guideline in addition to the Market Risk Management Policy. Moreover, the Bank also carries out backtesting which is essential to verify the capacity of the Bank’s VaR model to adequately forecast the maximum risk of market losses and thus validate, retroactively, the quality and accuracy of the results obtained using the model.

The VaR model simulates losses in market situations similar to those revealed by historical data, i.e., market conditions that are supposedly normal. The Bank also simulates the impact of abnormal situations, i.e., rare extreme events (such as a stock market crash) on the various portfolios of the Financial Markets segment. It does this by carrying out daily stress tests as well as sensitivity analyses for all risk categories: interest rate risk, equity and commodity price risk, foreign exchange risk and market volatility risk. Lastly, VaR exposure itself is stress-tested in an extreme scenario.

This battery of stress tests and sensitivity analyses simulate the results that the portfolios of the Financial Markets segment would generate if the extreme scenarios in question were to occur. Stress tests and sensitivity analyses are subject to maximum potential loss limits, which are approved by the Board. These tests and analyses are jointly established by the Risk Management Group and the management of the business units. They are regularly reviewed in light of changes in market conditions, new products and trading strategies.

Trading activities

The table below shows the VaR distribution of trading portfolios by risk category, as well as the correlation effect.

Global VaR by risk category⁽¹⁾

Year ended October 31	2010				2009
	Low	High	Average	Period end	Period end
Interest rate	(4.1)	(11.7)	(5.9)	(6.4)	(6.6)
Foreign exchange	(0.4)	(3.8)	(1.5)	(1.1)	(1.6)
Equity	(2.4)	(8.2)	(4.1)	(4.2)	(3.1)
Commodity	(0.4)	(2.3)	(1.0)	(1.0)	(1.6)
Correlation effect ⁽²⁾	n.m.	n.m.	6.4	5.7	7.3
Global VaR	(4.5)	(9.8)	(6.1)	(7.0)	(5.6)

n.m. – Computation of a correlation effect for the high and low is not meaningful as highs and lows may occur on different days and may be attributable to different types of risk.

(1) Amounts are presented on a pre-tax basis and represent one-day VaR.

(2) The correlation effect is the result of the diversification of types of risk.

NOTE 5 MANAGEMENT OF THE RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS (cont.)

Available-for-sale securities portfolios

The Bank has created available-for-sale securities portfolios made up of liquid or non-liquid securities for strategic, long-term investment and liquidity purposes. These investments carry not only market risk, but also credit risk, liquidity risk, concentration risk and reputational risk as well as risk of non-compliance with laws and regulations in effect.

The Investment Guidelines set out the guiding principles and general management standards to be followed by all those who manage portfolios of available-for-sale securities included in the portfolios of the Bank and its subsidiaries. Under these guidelines, business units that are active in managing this type of portfolio adopt internal investment policies that set, among other things, targets and limits for the allocation of assets in the portfolios concerned and internal approval mechanisms. The primary objective is to reduce concentration risk by industry, issuer, geographic location, type of financial instrument and credit quality. Overall limits are set on the total amount of non-liquid securities in the *Available-for-sale securities portfolios* in proportion to the Bank's equity, in the total invested in liquid equity securities excluding preferred shares and in the overall exposure to common shares with respect to an individual issuer. Lastly, the Bank has a specific strategic investment policy that is also approved by the Board which defines strategic investments as purchases of business assets or acquisitions of deemed material equity stake in an entity for purposes of acquiring control or creating a long-term relationship.

Structural interest rate risk

As part of its non-trading activities, such as granting mortgage loans and accepting term deposits, the Bank is exposed to structural interest rate risk. Interest rate movements cause changes in interest income and interest expense and, although these changes move in the same direction, their relative magnitude will have a favourable or unfavourable impact on net interest income and the economic value (present value of estimated cash flows) of shareholders' equity. The extent of that impact depends on several factors, including asset and liability matching and the interest rate curve. Assets and liabilities are managed to optimize the impact of interest rate movements in view of anticipated rate changes.

Regular simulations are performed to assess the impact of various scenarios on annual net interest income and on the economic value of shareholders' equity and to guide the management of structural interest rate risk.

Interest rate risk management is managed under a specific policy, the revision and application of which are overseen by various management committees, among others. The policy sets risk limits based on the impact of fluctuations in interest rates on the various parameters such as annual net interest income and economic value. In addition, the duration of shareholders' equity must be kept within certain limits.

The following table presents the potential before-tax impact of an immediate and sustained 100-basis-point increase or decrease in interest rates on net interest income and on the economic value of shareholders' equity of the Bank's non-trading portfolios, assuming no further hedging is undertaken.

Interest rate sensitivity – Non-trading activities (before tax)

As at October 31	2010	2009
100-basis-point increase in the interest rate		
Impact on net interest income (for the next 12 months)	17	19
Impact on shareholders' equity	(117)	(143)
100-basis-point decrease in the interest rate		
Impact on net interest income (for the next 12 months)	(24)	(5)
Impact on shareholders' equity	88	166

Hedging activities

Hedge of a net investment in a self-sustaining foreign operation

The Bank's structural foreign exchange risk arises from investments in self-sustaining foreign operations denominated in currencies other than the Canadian dollar. This risk is measured by assessing the impact of currency fluctuations. The Bank uses financial instruments (derivative and non-derivative) to hedge structural foreign exchange risk. In a hedge of a net investment in a self-sustaining foreign operation, the financial instruments used will offset foreign exchange gains and losses on the investments. When non-derivative financial instruments are designated as foreign exchange risk hedges, only the changes in value that are attributable to foreign exchange risk are taken into account in assessing and calculating the effectiveness of the hedge.

NOTE 5 MANAGEMENT OF THE RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS (cont.)

For the year ended October 31, 2010, unrealized foreign exchange losses of \$131 million (unrealized foreign exchange losses of \$193 million for the year ended October 31, 2009) were recorded in *Other comprehensive income* related to the Bank's net investment in self-sustaining foreign operations. These losses were respectively offset by gains of \$122 million (gains of \$219 million for the year ended October 31, 2009) related to financial instruments designated as foreign exchange risk hedges. Non-derivative financial instruments designated as hedges represent foreign currency-denominated liabilities and totalled \$1.7 billion as at October 31, 2010 (\$2.0 billion as at October 31, 2009).

As at October 31, 2010, a 1% appreciation (depreciation) of the value of the Canadian dollar would have reduced (increased) shareholders' equity by \$0.3 million.

Fair value hedge

Fair value hedge transactions mainly use interest rate swaps to hedge changes in the fair value of a financial asset or liability arising from interest rate fluctuations. In a fair value hedge, the change in fair value of the derivative financial instruments used as hedging items will offset the change in fair value of the hedged item. The Bank uses this strategy primarily for its securities, fixed-rate deposit and subordinated debenture portfolios.

For the year ended October 31, 2010, a loss of \$1 million representing the ineffective portion was recorded in *Other income* in the Consolidated Statement of Income (negligible amount for the year ended October 31, 2009). All the components of the change in fair value of the derivative financial instruments designated as hedges were taken into account in assessing the effectiveness of the fair value hedge.

Cash flow hedge

Cash flow hedge transactions mainly use interest rate swaps to hedge exposure of the future cash flows related to a floating-rate financial asset or liability. The Bank uses this strategy primarily for its loan portfolios, personal lines of credit and variable-rate deposits. The Bank also uses total return swaps to hedge the risk of changes in future cash flows related to the RSU Plan. Some of these swaps are designated as part of a cash flow hedge against a portion of the unrecognized obligation of the RSU Plan. In a cash flow hedge, the derivative financial instruments used as hedging items will mitigate the variability in future cash flows related to the hedged item.

For the year ended October 31, 2010, an unrealized gain of \$72 million (\$84 million for the year ended October 31, 2009) was recorded in *Other comprehensive income* for the effective portion of changes in fair value of derivative financial instruments designated as cash flow hedges. The amounts recognized are reclassified to *Net interest income* in the periods during which the cash flows of the hedged items are recognized. Consequently, a net gain of \$8 million was reclassified to net income in the year ended October 31, 2010 (\$67 million for the year ended October 31, 2009). An estimated net gain of \$142 million deferred in *Accumulated other comprehensive income* as at October 31, 2010 is expected to be reclassified to net income during the next 12 months. The maximum period over which the Bank hedges its exposure to the variability in future cash flows is 10 years.

For the year ended October 31, 2010, an unrealized gain representing the ineffective portion was recognized in *Other income* in the Consolidated Statement of Income in the amount of \$7 million (\$2 million for the year ended October 31, 2009). All the components of the change in fair value of the derivative financial instruments designated as hedges were taken into account in assessing and calculating the effectiveness of the cash flow hedge.

Liquidity risk management

Liquidity risk arises when sources of funds become insufficient to meet scheduled payments under the Bank's commitments. Liquidity risk stems from mismatched cash flows related to assets and liabilities as well as the characteristics of certain products, such as credit commitments and non-fixed term deposits.

The Bank's primary objective as a financial institution is to manage liquidity such that it supports the Bank's business strategy and enables it to honour its commitments when they come due, even in extreme conditions. This is done primarily by implementing a policy framework, approved by the Board, which establishes a risk tolerance threshold, monitoring structures controlled by the various committees, risk indicators, reporting procedures, delegation of responsibilities and segregation of duties.

Liquidity management

The Bank's funds transfer pricing system prices liquidity by allocating the cost to the various operating segments or by compensating them, as applicable. Liquidity costs are allocated to liquidity-intensive activities, mainly illiquid long-term loans, commitments to extend credit, illiquid securities as well as strategic investments. The liquidity compensation is credited to their suppliers of funds, primarily funding in the form of core deposits and securities eligible as collateral by central banks.

NOTE 5 MANAGEMENT OF THE RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS (cont.)

Short-term day-to-day funding decisions are based on a daily cumulative net cash position, which is controlled by means of limits set on liquidity ratios. In addition, the Bank closely monitors the nominal value of new funds obtained on the wholesale market with terms of one to seven days.

Moreover, the Bank's collateral pledging activities related to derivative financial instrument transactions (exchange-traded and over-the-counter contracts) are tracked on a daily basis in relation to the global limit set by the Bank and are tested once a month using a series of simulations. The Bank also regularly tracks unencumbered securities outstanding in proportion to its total assets and in proportion to unsecured institutional market funds due in less than one year. The Bank must hold unencumbered liquid assets outstanding at least equal to the total amount of wholesale funding maturing within one year.

The Bank's survival period, an indicator designed to measure the number of days it would take to utilize the Bank's liquid assets if the Bank were to lose deposits prematurely or if funds from the wholesale market were not renewed at maturity, is measured monthly using six scenarios. As at October 31, 2010, the Bank's consolidated surplus liquid asset position up to 90 days and measured in the course of normal operations, totalled \$21.4 billion compared to \$15.5 billion as at October 31, 2009. The surplus liquid asset position is total liquid assets, less secured and unsecured disbursement requirements and contingent liabilities. Another indicator known as "net cash capital," calculated monthly, measures the portion of term loans being used to finance the Bank's illiquid assets. Moreover, the Bank closely monitors its financial leverage to ensure that its assets-to-capital multiple respects the level prescribed by the Superintendent. Lastly, the Bank maintains an up-to-date liquidity contingency plan describing the measures to be taken in the event of a critical liquidity situation.

Funding

Core deposit liabilities are the Bank's primary funding source. In this context, diversification of funding by origination and term structure is an important element of a liquidity management strategy. The Bank seeks to diversify its funding sources by geographic location, currency, instrument, maturity and depositor. In addition, the Bank is actively involved in securitization programs (e.g., residential mortgages and credit card receivables) that give it access to long-term funding.

The following table presents financial liabilities and loan commitments by contractual maturity.

Contractual maturities

As at October 31						2010	2009
	Payable on demand and after notice	Payable on a fixed date					
		Less than 1 year	1 to 2 years	2 to 5 years	More than 5 years	Total	Total
Personal	19,627	5,508	4,282	4,600	95	34,112	34,609
Other	20,516	21,194	1,833	3,205	925	47,673	40,561
Total deposits	40,143	26,702	6,115	7,805	1,020	81,785	75,170
		Less than 1 year	1 to 2 years	2 to 5 years	More than 5 years	No maturity	Total
Obligations related to securities sold short		—	—	—	—	18,292	13,221
Securities sold under repurchase agreements		12,513	—	—	—	—	12,736
Designated derivative financial instruments							
Fair value hedges		—	2	82	110	—	35
Cash flow hedges		—	—	—	19	—	53
Total designated derivative financial instruments		—	2	82	129	—	88
Derivative financial instruments held-for-trading		1,338	956	2,651	1,473	—	5,859
Subordinated debentures		183	500	850	500	—	2,017
Loan commitments		29,519	—	—	—	—	29,463

NOTE 6

CAPITAL DISCLOSURE

Capital management objectives, policies and procedures

Capital management consists of maintaining the balance between risk-adjusted capital, regulatory capital ratios that satisfy the minimum requirements for a well-capitalized financial institution, as defined by the Superintendent and the production of a competitive return on shareholders' equity.

Each year, the Board, on the recommendation of the ARMC, approves a detailed capital management policy and the Bank's capital plan. This policy sets out the principles and practices the Bank incorporates into its capital management strategy and the basic criteria it adopts to ensure that it has a sufficient level of capital at all times and prudently manages such capital in view of its future capital requirements. The capital plan sets operational targets and takes into account expected levels for risk-weighted assets, determined under the regulatory approach. Moreover, the capital plan presents an analysis of the different strategies that are available to the Bank to optimize capital management, including the issuance and repurchase of equity securities and subordinated debt securities and the dividend policy.

Capital management

The capital ratio is the ratio, expressed as a percentage, of regulatory capital to risk-weighted assets. Risk-weighted assets are calculated in accordance with the rules established by the Superintendent for balance sheet and off-balance sheet risks. Credit, market and operational risks are considered in calculating risk assets for regulatory purposes. The definition adopted by the Bank for International Settlements (BIS) distinguishes between three types of capital: Tier 1 capital, which consists mainly of common shareholders' equity and non-cumulative preferred shareholders' equity, the eligible amount of innovative instruments and non-controlling interests, less goodwill; and Tier 2 capital, which consists of preferred shares not eligible for Tier 1 capital, the eligible portion of subordinated debentures, the eligible general allowance for credit risk as well as the eligible amount of innovative instruments that cannot be included in Tier 1 capital. In accordance with BIS rules, the Superintendent defines a third tier of capital intended specifically to cover market risk, which is also covered by Tier 1 capital. Total regulatory capital is the sum of all capital net of investments in companies subject to significant influence and first-loss protection with respect to asset securitization.

On November 1, 2007, the Bank adopted the requirements of the Basel II Accord capital standards. These rules, established in 2004 by the BIS in Basel, Switzerland, and adopted by many countries around the world, including Canada, amend the capital adequacy rules introduced in 1988.

Since November 1, 2009, the Bank has been applying the Advanced Internal Rating-Based approach (AIRB approach) for credit risk; prior to that date, it had been using the Standardized Approach. With respect to operational risk, the Bank is using the Standardized Approach. For market risk, it continues to use internal models and the Standardized Approach in accordance with the Basel II Accord.

The Superintendent considers financial institutions to be well-capitalized if they maintain a Tier 1 capital ratio of 7% and a total regulatory capital ratio of 10%. The Bank maintained ratios that satisfied these requirements in both 2010 and 2009.

In addition to regulatory capital ratios, banks are expected to meet an assets-to-capital multiple test. The assets-to-capital multiple is calculated by dividing a bank's total assets, including specified off-balance sheet items, by its total capital. The Bank met the assets-to-capital multiple test in both 2010 and 2009.

NOTE 6 CAPITAL DISCLOSURE (cont.)

Regulatory capital according to Basel II

As at October 31	2010 ⁽¹⁾	2009
Tier 1 capital		
Common shares	1,804	1,729
Contributed surplus	66	48
Retained earnings	4,081	3,515
Unrealized foreign currency translation gains (losses), net of hedging activities and after tax, included in <i>Accumulated other comprehensive income</i>	(133)	(100)
Accumulated net after-tax unrealized losses on available-for-sale equity securities included in <i>Accumulated other comprehensive income</i>	–	(11)
Non-cumulative permanent preferred shares	1,089	1,089
Innovative instruments ⁽²⁾	975	971
Non-controlling interests ⁽³⁾	25	19
Trading in short positions of shares of the Bank	(17)	(10)
Gross Tier 1 Capital	7,890	7,250
Goodwill	(744)	(746)
Other deductions	–	(35)
Net Tier 1 Capital	7,146	6,469
Gains on sales recorded upon securitization	(40)	(36)
Other deductions	(136)	(168)
Adjusted Net Tier 1 Capital	6,970	6,265
Tier 2 Capital		
Subordinated debentures	1,894	1,897
Eligible general allowance for credit risk	79	456
Accumulated net after-tax unrealized gains on available-for-sale equity securities included in <i>Accumulated other comprehensive income</i>	13	–
Excess Tier 1 qualifying innovative instruments ⁽²⁾	–	4
Tier 2 Capital	1,986	2,357
Other deductions	(259)	(223)
Adjusted Tier 2 Capital	1,727	2,134
Total capital	8,697	8,399

(1) Since November 1, 2009, the Bank has been applying the Advanced Internal Rating-Based Approach for credit risk; prior to that date, it had been using the Standardized Approach.

(2) 400,000 NBC CapS II – Series 1 and 350,000 NBC CapS II – Series 2 issued by NBC Asset Trust presented in *Non-controlling interests* and the 225,000 NBC CapS – Series I issued by NBC Capital Trust.

(3) Excluding 400,000 NBC CapS II – Series 1 and 350,000 NBC CapS II – Series 2 issued by NBC Asset Trust, mutual funds and other entities consolidated pursuant to the application of AcG-15.

NOTE 7

TRADING ACTIVITY REVENUES

Trading activity revenues comprise net interest income from trading activities, trading revenues recognized as *Other income* and the impact of non-controlling interests.

Net interest income comprises interest and dividends related to financial assets and liabilities associated with trading activities, net of interest expenses and interest income related to the financing of these financial assets and liabilities.

Other income comprises the realized and unrealized gains and losses on securities held-for-trading, income from derivative financial instruments held-for-trading and the change in fair value of financial instruments designated as held-for-trading.

The impact of non-controlling interests takes into account trading revenues and losses attributable to third parties.

Revenues from trading activities

Year ended October 31	2010	2009
Net interest income	440	444
Other income	(78)	12
Non-controlling interests	(5)	2
Total	357	458

NOTE 8

AVAILABLE-FOR-SALE SECURITIES

Available-for-sale securities are presented in the following table:

As at October 31	2010					2009
	Term to maturity					
	Less than 1 year	1 to 5 years	More than 5 years	No maturity	Total	Total
Securities issued or guaranteed by:						
Canada	62	4,796	1,024	—	5,882	9,014
Provinces	39	590	1,928	—	2,557	1,876
Municipalities or school boards	—	85	253	—	338	274
U.S. Treasury and other U.S. agencies	378	—	3	—	381	92
Other debt securities	26	205	213	401	845	947
Equity securities	25	77	12	880	994	1,078
Total available-for-sale securities	530	5,753	3,433	1,281	10,997	13,281

AVAILABLE-FOR-SALE SECURITIES (cont.)

Gross unrealized gains (losses) on available-for-sale securities

As at October 31	2010			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying value
Securities issued or guaranteed by:				
Canada	5,782	100	–	5,882
Provinces	2,420	138	(1)	2,557
Municipalities or school boards	316	22	–	338
U.S. Treasury and other U.S. agencies	381	–	–	381
Other debt securities	825	24	(4)	845
Equity securities	975	66	(47)	994
Total available-for-sale securities	10,699	350	(52)	10,997
As at October 31	2009			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying value
Securities issued or guaranteed by:				
Canada	8,973	69	(28)	9,014
Provinces	1,853	58	(35)	1,876
Municipalities or school boards	267	16	(9)	274
U.S. Treasury and other U.S. agencies	92	–	–	92
Other debt securities	937	49	(39)	947
Equity securities	1,091	53	(66)	1,078
Total available-for-sale securities	13,213	245	(177)	13,281

Gross unrealized losses

Available-for-sale securities are measured periodically to determine whether there is objective evidence of an impairment. Gross unrealized losses on equity securities are mainly caused by market price fluctuations or foreign exchange movements. The Bank has the ability and intent to hold these securities for a period of time sufficient to allow for any recovery of their fair value. As at October 31, 2010 and 2009, the Bank concluded that the gross unrealized losses, recognized in *Other comprehensive income*, were temporary.

Impairment charges

During the year ended October 31, 2010, a \$9 million (\$37 million for the year ended October 31, 2009) impairment charge relating to a decline in value, which the Bank considered other than temporary, of available-for-sale securities was recognized in *Losses on available-for-sale securities, net* in the Consolidated Statement of Income.

Available-for-sale securities presented at cost

The Bank holds equity securities such as mutual fund units and other securities that are classified as available-for-sale but must be presented at cost because they are not traded in an active market. As at October 31, 2010, these available-for-sale securities presented at cost in the Consolidated Balance Sheet totalled \$379 million (\$387 million as at October 31, 2009). The difference between the estimated fair value and the cost represented an unrealized gain of \$13 million as at October 31, 2010 (\$39 million as at October 31, 2009). Some available-for-sale securities presented at cost in the Consolidated Balance Sheet were sold during the year. When they were sold, their carrying value was \$65 million (\$8 million as at October 31, 2009), and the Bank recognized a \$4 million loss on their sale (\$11 million gain for the year ended October 31, 2009).

NOTE 9

MASTER ASSET VEHICLES

As at October 31, 2010, the face value of the restructured notes of the master asset vehicle (MAV) conduits held by the Bank was \$1,926 million (\$1,954 million as at October 31, 2009), of which \$1,664 million was designated as *Held-for-trading securities* under the fair value option, and an amount of \$262 million was classified in *Available-for-sale securities* (\$1,685 million designated as *Held-for-trading securities* and \$269 million classified in *Available-for-sale securities* as at October 31, 2009). During fiscal 2010, the Bank received capital repayments related to the restructured notes of the MAV conduits, certain restructured notes were taken back from clients who had credit facilities backed by these notes, and certain notes were written off.

The table below provides a breakdown of the face value of the restructured notes of the MAV conduits (which replaced asset-backed commercial paper "ABCP" under the restructuring plan for these instruments) held by the Bank:

As at October 31	2010	2009
MAV I		
Class A-1	601	604
Class A-2	553	553
Class B	94	94
Class C	39	39
IA tracking notes for ineligible assets	44	77
Total MAV I	1,331	1,367
MAV II		
Class A-1	106	98
Class A-2	87	79
Class B	18	14
Class C	7	6
IA tracking notes for ineligible assets	12	11
Total MAV II	230	208
MAV III		
TA tracking notes for traditional assets	53	85
IA tracking notes for ineligible assets	171	148
Total MAV III	224	233
ABCP not included in the Pan-Canadian restructuring plan	141	146
Total	1,926	1,954

As part of the Montreal Accord restructuring, swap counterparties to MAV I and MAV II agreed to an 18-month post-closing moratorium period during which time margin calls could not occur. On July 16, 2010, the moratorium period expired. As a result, certain transactions held by the MAVs are now exposed to collateralization triggers. The Bank has committed to contribute \$911 million to a margin funding facility in order to finance potential collateral calls. As at October 31, 2010, no amount had been advanced by the Bank.

NOTE 9 MASTER ASSET VEHICLES (cont.)

Establishing fair value

The carrying value of the restructured notes of the MAV conduits held by the Bank in an investment portfolio as at October 31, 2010, designated as *Held-for-trading securities*, was \$1,147 million, and \$53 million was classified in *Available-for-sale securities* (\$1,147 million designated as *Held-for-trading securities* and \$78 million classified in *Available-for-sale securities* as at October 31, 2009). The notes held in an investment portfolio with one or more embedded derivatives were designated as *Held-for-trading securities* under the fair value option, and the other notes were classified in *Available-for-sale securities*. The Bank took back restructured notes of the MAV conduits related to the credit facilities at a fair value of \$36 million during the year ended October 31, 2010. The table below provides a breakdown of the carrying value of the restructured notes of the MAV conduits held by the Bank:

Table of contractual maturities

As at October 31	2010			2009		
	1 to 5 years	More than 5 years	Total	1 to 5 years	More than 5 years	Total
MAV I and MAV II	6	1,112	1,118	6	1,103	1,109
MAV III	6	38	44	24	48	72
ABCP not included in the Pan-Canadian restructuring plan	15	23	38	19	25	44
Carrying value of the notes	27	1,173	1,200	49	1,176	1,225
Margin funding facilities	—	(55)	(55)	—	(63)	(63)
Total	27	1,118	1,145	49	1,113	1,162

In establishing the fair value of the restructured notes of the MAV conduits and excluding ineligible assets, the Bank considered the quality of the underlying assets. The Bank determined fair value using the discounted cash flow method. The discount rate is based 80% on the CDX.IG index tranches and 20% on a basket of securities backed by assets such as credit card receivables, Residential Mortgage-Backed Securities (RMBS), Commercial Mortgage-Backed Securities (CMBS) and automobile loans. The credit ratings and coupons were based on the terms set out in the restructured notes of the MAV conduits. Maturities are based on the anticipated cash flows of the underlying assets.

For ineligible assets, the fair value of the tracking notes is based on an analysis of the underlying assets of the notes and the market value of comparable instruments. For RMBS, fair values were based on the ABX index; for CMBS, CMBS indices, including the CMBX index, were chosen. As for derivative financial instruments, the Bank used valuation models which are commonly used by market participants with inputs that are based on factors observable in the markets such as the CDX.IG indices and the base correlation and interest rates.

To determine the value of the restructured notes of the MAV conduits it is holding, the Bank compares the value obtained using the above-described methodology against a range of values. The values situated in this range were obtained from third parties and are adjusted to take liquidity into consideration. As several assumptions may be used in determining fair value, this range reflects the level of uncertainty associated with these models.

Since the carrying value of the restructured notes of the MAV conduits held by the Bank was within the range of the estimated fair value as at October 31, 2010, no change was made to the carrying value as at October 31, 2010. On September 21, 2010, the ratings of MAV I and MAV II Class A-1 notes were upgraded to "A (high) (sf)" from "A (sf)," and the ratings were removed from "under review with positive implications" where they had been placed on June 22, 2010. At the same time, the ratings on MAV I and MAV II Class A-2 notes were kept at "A (sf)" and "BBB (low) (sf)."

The Bank's valuation was based on its assessment of the conditions prevailing as at October 31, 2010, which may change in subsequent periods. The most significant assumptions used to determine the fair value of the restructured notes are observable discount rates and the credit ratings of the notes. The sensitivities of these assumptions on fair value as at October 31, 2010 are as follows:

- A 10-basis-point change in the discount rate would result in a \$9 million decrease or increase in the fair value;
- A decrease in the credit rating by one letter grade would result in a decrease in the fair value between a range of \$45 million to \$80 million; and
- An increase in the credit rating by one letter grade would result in an increase in the fair value between a range of \$40 million to \$50 million.

Determining the fair value of restructured notes of the MAV conduits is complex and involves an extensive process that includes the use of quantitative modelling and relevant assumptions. Possible changes that could have a significant impact on the future value include (1) changes in the value of the underlying assets, (2) changes regarding the liquidity of the restructured notes of the MAV conduits which are not currently traded on an active market, (3) the impacts of a marked and prolonged economic slowdown in North America, and (4) changes in legislation.

NOTE 9 MASTER ASSET VEHICLES (cont.)

Credit facilities to clients holding restructured notes of the MAV conduits

As at October 31, 2010, credit facilities outstanding provided to clients holding restructured notes of the MAV conduits stood at \$143 million (\$285 million as at October 31, 2009) and the allowance for credit losses was \$121 million (\$148 million as at October 31, 2009). In total, the collateral related to the credit facilities offered to clients is estimated as follows:

Collateral as at October 31		2010	
	Face value of the notes	Credit facilities backed by IA tracking notes ⁽¹⁾	Credit facilities backed by restructured notes of the MAV conduits ⁽²⁾
MAV II			
Class A-1	302	—	244
Class A-2	277	—	225
Class B	50	—	41
Class C	19	—	15
IA tracking notes for ineligible assets	107	70	—
Total MAV II	755	70	525
MAV III			
TA tracking notes for traditional assets	15	—	13
IA tracking notes for ineligible assets	110	79	—
Total MAV III	125	79	13
Total	880	149	538

Collateral as at October 31		2009	
	Face value of the notes	Credit facilities backed by IA tracking notes ⁽¹⁾	Credit facilities backed by restructured notes of the MAV conduits ⁽²⁾
MAV II			
Class A-1	423	—	327
Class A-2	405	—	311
Class B	73	—	56
Class C	28	—	22
IA tracking notes for ineligible assets	130	94	—
Total MAV II	1,059	94	716
MAV III			
TA tracking notes for traditional assets	45	—	27
IA tracking notes for ineligible assets	156	130	—
Total MAV III	201	130	27
Total	1,260	224	743

(1) These credit facilities represent 75% of the face value of the notes and are guaranteed by the notes, less repayment of their capital.

(2) These credit facilities represent 75% of the face value of the notes, of which 30% are full recourse to the borrower and 45% guaranteed by the notes, less repayment of their capital.

Regulatory investigation

On December 21, 2009, the Bank's investment dealer subsidiary, National Bank Financial (NBF), agreed to a settlement of \$75 million with the Autorité des marchés financiers du Québec (AMF). This agreement is one of a series of agreements concluded between securities regulators and financial institutions involved in Third Party ABCP in 2007. The settlement amount was recorded as a charge in *Operating expenses – Other* in the Consolidated Statement of Income during fiscal 2010.

An administrative penalty of \$70 million, plus \$1 million in investigation costs, was paid to the AMF. As part of its communication programs, the Bank has also agreed to invest \$4 million in a financial education campaign for the benefit of public investors over the next two years. This program is a complement to the AMF's own efforts at investor education.

NOTE 10

HELD-FOR-TRADING SECURITIES

As at October 31	2010					2009
	Term to maturity				Total	Total
	Less than 1 year	1 to 5 years	More than 5 years	No maturity		
Securities issued or guaranteed by:						
Canada	7,336	2,213	2,123	–	11,672	11,687
Provinces	1,729	2,382	2,872	–	6,983	6,009
Municipalities or school boards	132	228	56	–	416	494
U.S. Treasury and other U.S. agencies	91	186	243	–	520	1,025
Other debt securities	682	1,391	1,829	59	3,961	5,133
Equity securities	12	15	–	19,692	19,719	12,604
Total held-for-trading securities	9,982	6,415	7,123	19,751	43,271	36,952

NOTE 11

TRANSFERS OF RECEIVABLES

Asset securitization

New securitization activities

Insured mortgage loans and credit card receivables

The Bank securitizes insured residential mortgage loans by creating mortgage-backed securities. Under a 1998 agreement, the Bank also sells credit card receivables on a revolving basis to a trust. The pre-tax gain or loss from securitization transactions, net of transaction fees, is recognized in the Consolidated Statement of Income under *Securitization revenues*.

Year ended October 31	2010		2009
	Insured mortgage loans	Credit card receivables	Insured mortgage loans
Net cash proceeds	4,129	547 ⁽¹⁾	3,690
Asset-backed securities purchased ⁽²⁾	–	37	–
Retained rights to future excess interest	210	17	274
Retained servicing liability	(24)	(3)	(22)
	4,315	598	3,942
Receivables securitized and sold	4,177	587	3,735 ⁽³⁾
Gain before income taxes, net of transaction fees	138	11	207
Mortgage-backed securities created and retained included in <i>Available-for-sale securities</i>	669	–	–

(1) The net cash proceeds received is equal to the gross proceeds of \$587 million, less the \$37 million used to purchase the securities issued by the Trust and the transaction fees.

(2) These securities are presented under *Available-for-sale securities* in the Consolidated Balance Sheet.

(3) Includes \$160 million in receivables securitized in previous fiscal years.

Maturity

Credit card receivables

Certificates totalling \$450 million, which had been issued by a trust in 2005 under the securitization program and backed by the Bank's credit card receivables, matured in April 2010.

NOTE 11 TRANSFERS OF RECEIVABLES (cont.)

Key assumptions

The key assumptions used to measure the fair value of retained rights to future excess interest as at the securitization date for transactions carried out during 2010 and 2009 were as follows:

Year ended October 31	2010		2009		2010	2009
			Insured mortgage loans		Credit card receivables	
	Variable rate	Fixed rate	Variable rate	Fixed rate		
Weighted average term (months)	29.7	29.4	29.2	30.7	—	—
Payment rate (per month)	—	—	—	—	29.8%	27.4%
Prepayment rate	17.0%	19.0%	19.5%	17.3%	—	—
Excess spread, net of credit losses	1.3%	2.3%	1.2%	3.1%	11.8%	10.5%
Expected credit losses	—	—	—	—	5.3%	5.1%
Discount rate	1.3%	1.9%	0.6%	2.0%	17.0%	17.0%

The static pool credit loss ratio for securitized credit card receivables as at October 31, 2010 was 1.36% (1.31% in 2009). It is calculated by dividing actual and projected credit losses by the original balance of the receivables securitized. Static pool credit losses are not applicable to insured mortgage loans.

Managed loans

The capital balance of the loans, the amount of impaired loans and other loans past due, and the amount of net write-offs for all loans presented on the Consolidated Balance Sheet and managed securitized loans are as follows:

As at October 31	2010			2009		
	Total gross loans	Gross impaired loans and other past due loans ⁽¹⁾	Net write-offs	Total gross loans	Gross impaired loans and other past due loans ⁽¹⁾	Net write-offs
Residential mortgage	25,410	95	(5)	23,241	102	(4)
Personal and credit card	21,909	185	158	19,536	153	155
Business and government	21,469	365	34	20,003	481	48
Total loans	68,788	645	187	62,780	736	199
Less: Mortgage-backed securities created and retained included in <i>Available-for-sale securities</i>	822	—	—	298	—	—
Less: Securitized and managed loans						
Insured mortgage loans	8,318	—	—	7,453	—	—
Credit card receivables	1,360 ⁽²⁾	9	66	1,223 ⁽³⁾	9	66
Less: Mortgage loans sold to a mutual fund administered by the Bank	464	—	—	529	—	—
Total loans presented on the Consolidated Balance Sheet	57,824	636	121	53,277	727	133

(1) Comprises impaired loans and loans that are 90 days or more past due but are fully secured and for which, in the opinion of Management, there is reasonable assurance that principal and interest will ultimately be collected. Credit card receivables are not classified as impaired loans but, instead, are written off when payments are 180 days in arrears.

(2) Comprises \$60 million in mortgage-backed securities included in *Available-for-sale securities* in the Consolidated Balance Sheet.

(3) Comprises \$23 million in mortgage-backed securities included in *Available-for-sale securities* in the Consolidated Balance Sheet.

NOTE 11 TRANSFERS OF RECEIVABLES (cont.)

Impact of securitization activities on certain items in the Consolidated Statement of Income
Securitization revenues

Year ended October 31	2010	2009	2010	2009	2010	2009	2010	2009
	Gains on sale of assets		Servicing revenues		Other		Total	
Insured mortgage loans	138	207	21	20	–	–	159	227
Credit card receivables ⁽¹⁾	95	95	22	23	13	6	130	124
Total	233	302	43	43	13	6	289	351

(1) Revolving securitization transactions and new securitization activities.

Impact of securitization activities on certain items in the Consolidated Balance Sheet

As at October 31	2010	2009	2010	2009
	Available-for sale securities Retained interests		Other liabilities Servicing liability	
Insured mortgage loans	360	311	40	34
Credit card receivables	40	36	7	7
Total	400	347	47	41

Cash flows from securitization activities

Year ended October 31	2010		2009		2010	2009
			Insured mortgage loans		Credit card receivables	
	Variable rate	Fixed rate	Variable rate	Fixed rate		
Proceeds from new securitizations	906	3,223	187	3,503	547	–
Proceeds collected and reinvested in revolving securitizations	–	–	–	–	3,951	3,998
Cash flows from retained interests in securitizations	16	158	7	137	130	130
Maturity	–	–	–	–	(450)	–

NOTE 11 TRANSFERS OF RECEIVABLES (cont.)

Sensitivity of key assumptions to adverse changes

The sensitivity of the current fair value of retained rights to future excess interest to immediate 10% and 20% adverse changes in key assumptions was as follows:

As at October 31	2010		2009		2010	2009
			Insured mortgage loans		Credit card receivables	
	Variable rate	Fixed rate	Variable rate	Fixed rate		
Weighted average term (months)	33.3	33.1	24.7	32.2	–	–
Prepayment rate	17.8%	18.1%	19.9%	17.7%	29.8%	27.4%
Impact on fair value of 10% adverse change	\$ (0.6)	\$ (9.3)	\$ (0.2)	\$ (8.6)	\$ (3.0)	\$ (2.6)
Impact on fair value of 20% adverse change	\$ (1.3)	\$ (18.4)	\$ (0.4)	\$ (16.9)	\$ (5.4)	\$ (4.7)
Excess spread, net of credit losses	1.2%	2.3%	1.2%	2.2%	11.8%	10.5%
Impact on fair value of 10% adverse change	\$ (2.7)	\$ (33.7)	\$ (1.0)	\$ (30.1)	\$ (4.1)	\$ (3.7)
Impact on fair value of 20% adverse change	\$ (5.4)	\$ (67.4)	\$ (2.0)	\$ (61.7)	\$ (8.2)	\$ (7.3)
Expected credit losses	–	–	–	–	5.3%	5.1%
Impact on fair value of 10% adverse change	–	–	–	–	\$ (1.8)	\$ (1.8)
Impact on fair value of 20% adverse change	–	–	–	–	\$ (3.7)	\$ (3.5)
Discount rate	1.3%	2.6%	0.7%	3.0%	17.0%	17.0%
Impact on fair value of 10% adverse change	–	\$ (0.9)	–	\$ (1.0)	\$ (0.2)	\$ (0.1)
Impact on fair value of 20% adverse change	\$ (0.1)	\$ (1.8)	–	\$ (2.0)	\$ (0.3)	\$ (0.3)

These sensitivities are hypothetical and should be used with caution. Changes in fair value attributable to changes in assumptions generally cannot be extrapolated because the relationship between the change in assumption and the change in fair value may not be linear. Changes affecting a given factor may result in changes to another, which might magnify or counteract the sensitivities attributable to changes in assumptions.

Other transfers

The Bank sells insured and uninsured mortgage loans to a mutual fund administered by the Bank. The pre-tax gain or loss is recorded in *Other income – Other* in the Consolidated Statement of Income. The total outstanding amount of insured and uninsured mortgage loans sold to this mutual fund was \$464 million as at October 31, 2010 (\$529 million as at October 31, 2009). The table below summarizes the other transfers carried out by the Bank.

Year ended October 31	2010	2009
Net cash proceeds	77	411
Uninsured mortgage loans sold	76	399
Gain before income taxes	1	12

NOTE 12

FINANCIAL ASSETS TRANSFERRED BUT NOT DERECOGNIZED

In the course of its operations, the Bank concludes transactions in which it transfers financial assets to a third party which are presented in the Consolidated Balance Sheet because the transactions do not qualify for derecognition.

Carrying values of transferred financial assets

As at October 31	2010	2009
Securities sold under repurchase agreements	12,625	12,599
Loaned securities	8,320	7,086

NOTE 13

VARIABLE INTEREST ENTITIES

The VIEs where the Bank holds a significant variable interest but is not the primary beneficiary, as defined in AcG-15, are described below. The Bank's maximum exposure to loss resulting from these variable interests consists primarily of investments in these entities, the fair value of the derivative contracts entered into with them and the backstop liquidity and credit enhancement facilities granted to one of them.

Securitization entity for the Bank's assets

The Bank carries out transactions in which certain assets are sold to an entity that finances their purchase by issuing term bonds. This entity is a qualifying special-purpose entity under AcG-12 and is therefore exempt from the consolidation requirements under AcG-15. Asset securitization transactions for the years ended October 31, 2010 and 2009 are described in Note 11 to the consolidated financial statements.

Multi-seller conduit

The Bank administers a multi-seller conduit that purchases financial assets from clients and finances those purchases by issuing asset-backed commercial paper. Clients use this multi-seller conduit to diversify their funding sources and reduce funding costs, while benefiting from financial asset management services and providing some amount of first-loss protection. The Bank acts as a financial agent and provides administrative and transaction structuring services to this conduit. The Bank provides backstop liquidity and credit enhancement facilities under the commercial paper program. These facilities are presented and described in Note 28 to the consolidated financial statements. The Bank can hold significant variable interests in this conduit because of the following: the backstop liquidity and credit enhancement facilities provided to the conduit, the collection of fees as a financial agent and administrator, and the Bank's occasional participation in the commercial paper program. However, unrelated third parties assume the first credit losses before the commercial paper holders. The Bank is not required to consolidate this conduit under AcG-15 because it does not have to absorb the majority of the conduit's expected losses or receive the majority of its expected residual returns. In order to meet the needs of investors, the Bank has concluded derivative contracts with this conduit, the fair value of which is presented on the Bank's Consolidated Balance Sheet. The total assets of this conduit were \$1,152 million as at October 31, 2010 (\$494 million as at October 31, 2009).

Master asset vehicles

The Bank holds significant variable interests in master asset vehicles (MAV) due to the holding of restructured notes of the MAV conduits and the margin funding facility provided. Under AcG-15, the Bank is not the primary beneficiary of these master asset vehicles and is therefore not required to consolidate them. For additional information, see Note 9.

Investment funds

As part of its investment banking operations, the Bank invests in several limited liability partnerships and incorporated entities. These investment companies in turn invest in operating companies with a view to reselling these investments at a profit over the medium or long term. The Bank does not intervene in the operations of these entities; its only role is that of an investor. The Bank is not required to consolidate these entities under AcG-15 as it does not absorb the majority of their expected losses or receive the majority of their expected residual returns. As at October 31, 2010, the recorded value of the Bank's total investment was \$136 million (\$145 million as at October 31, 2009). The total assets of all these entities amounted to \$1.5 billion as at October 31, 2010 (\$1.6 billion as at October 31, 2009). Moreover, the Bank has commitments to invest in these entities. These commitments are disclosed in Note 28 to the consolidated financial statements.

NOTE 14

PREMISES AND EQUIPMENT

As at October 31	2010			2009		
	Cost	Accumulated amortization	Net carrying value	Cost	Accumulated amortization	Net carrying value
Land	15	—	15	15	—	15
Buildings	199	109	90	187	102	85
Equipment and furniture	405	328	77	387	321	66
Computer equipment under a capital lease	85	19	66	85	7	78
Leasehold improvements	477	344	133	447	329	118
Total	1,181	800	381	1,121	759	362

The amortization expense for the year ended October 31, 2010 was \$64 million (\$49 million for the year ended October 31, 2009).

NOTE 15

GOODWILL AND INTANGIBLE ASSETS

The Bank performs an annual impairment test of goodwill and intangible assets with indefinite useful lives. No impairment loss was recorded for 2009.

The change in the carrying value of goodwill was as follows:

	Personal and Commercial	Wealth Management	Financial Markets	Total
Balance as at October 31, 2008	61	455	224	740
Other ⁽¹⁾	5	4	(3)	6
Balance as at October 31, 2009	66	459	221	746
Other ⁽¹⁾	(1)	—	(1)	(2)
Balance as at October 31, 2010	65	459	220	744

(1) Represents the impact of translating goodwill denominated in foreign currencies and adjustments made to previous acquisitions.

Intangible assets comprise the following:

As at October 31	2010				2009		
	Cost	Impairment ⁽¹⁾	Accumulated amortization	Net carrying value	Cost	Accumulated amortization	Net carrying value
Software and technology development	676	—	374	302	539	321	218
Management contracts ⁽²⁾	154	2	—	152	154	—	154
Trademarks ⁽²⁾	11	—	—	11	11	—	11
Other	21	—	6	15	33	19	14
Total	862	2	380	480	737	340	397

(1) Following impairment tests, an impairment charge was recognized.

(2) Not subject to amortization.

The amortization expense and total write-offs for the year ended October 31, 2010 totalled \$58 million (\$63 million for the year ended October 31, 2009).

NOTE 16

OTHER ASSETS

As at October 31	2010	2009
Interest and dividends receivable	352	379
Prepaid expenses	328	341
Future income tax assets (Note 26)	102	91
Investments in companies subject to significant influence	158	243
Accrued benefit asset (Note 23)	648	617
Other	525	400
	2,113	2,071

NOTE 17

DEPOSITS

As at October 31	2010			2009
	Payable on demand and after notice	Payable on a fixed date	Total	Total
Personal	19,627	14,485	34,112	34,609
Business and government	19,101	22,884	41,985	36,698
Deposit-taking institutions	1,415	4,048	5,463	3,638
Deposit from NBC Capital Trust	–	225	225	225
	40,143	41,642	81,785	75,170

Deposit from NBC Capital Trust

On June 15, 2006, NBC Capital Trust (the Trust), an open-end trust established under the laws of the Province of Ontario, issued transferable non-voting trust units called Trust Capital Securities – Series 1, or NBC CapS – Series 1. The gross proceeds of \$225 million from the offering were used by the Trust to acquire a deposit note from the Bank.

The Trust is a variable interest entity as defined in AcG-15. Although the Bank owns the equity and controls the voting rights of the Trust, it is not the primary beneficiary of the Trust and therefore does not consolidate it; consequently, the NBC CapS – Series 1 issued by the Trust are not included in the Consolidated Balance Sheet of the Bank, but the deposit note is presented under *Deposits*.

Deposit note

The main terms and characteristics of the \$225 million deposit note are as follows:

Issuance date	Fixed annual interest rate	Interest payment dates	Semi-annual payment ⁽¹⁾	Maturity	Date of conversion at the option of the Trust ⁽²⁾	Date of redemption at the option of the Bank ⁽³⁾
June 15, 2006	5.329% ⁽⁴⁾	June 30, December 31	\$26.645	June 30, 2056	Anytime	June 30, 2011

(1) Per \$1,000 principal amount.

(2) Each \$1,000 principal amount of the deposit note is convertible at the option of the Trust into 40 First Preferred Shares, Series 17 of the Bank (Note 22). The Trust will exercise this conversion right in circumstances in which holders of NBC CapS – Series 1 exercise their exchange right.

(3) The Bank may, at its option, redeem the deposit note, in whole or in part, on the date indicated above (and on any subsequent interest payment date), or prior to that date in whole (but not in part) upon the occurrence of predetermined regulatory events or tax events. Any redemption may be carried out without the consent of the Trust, subject to prior written notice and Superintendent approval. If the Bank redeems the deposit note in whole or in part, the Trust will be required to redeem a corresponding amount of NBC CapS – Series 1.

(4) The rate of 5.329% will be in effect up to and including June 30, 2016. After that date, the note will bear interest at a fixed annual rate equal to the 180-day bankers' acceptance rate in effect plus 1.50%.

Purchase for cancellation

On or after June 30, 2011, the Bank may, with Superintendent approval, purchase the deposit note in whole or in part on the open market by tender or private contract at any price. Any part of the deposit note purchased by the Bank will be cancelled and will not be reissued.

Instances of default

Failure by the Bank to make payments or to satisfy its other obligations under the deposit note will not entitle the Trust to accelerate payment of the deposit note.

NOTE 17 DEPOSITS (cont.)

Trust units issued by NBC Capital Trust

No cash distributions will be payable by the Trust on NBC CapS – Series 1, if the Bank fails to declare regular dividends on its preferred shares or, if no preferred shares are then outstanding, on its outstanding common shares. In this case, the net distributable funds of the Trust will be paid to the Bank in its capacity as holder of the Special Trust Securities, representing the residual interest in the Trust. Should the Trust fail to pay the semi-annual distributions in full on the NBC CapS – Series 1, the Bank will not declare dividends on any of its preferred shares and common shares for a specified period of time. The NBC CapS – Series 1 are not redeemable at the option of the holder.

The main terms and characteristics of the NBC CapS – Series 1 trust units are presented below:

	Number	Issuance date	Annual yield	Distribution date	Semi-annual distribution by NBC CapS – Series 1 ⁽¹⁾	Date of conversion at the option of the holder ⁽²⁾	Date of redemption at the option of the Trust ⁽³⁾
Series 1	225,000	June 15, 2006	5.329%	June 30, December 31	\$26.645 ⁽⁴⁾	Anytime	June 30, 2011

(1) For each unit with a face value of \$1,000.

(2) Holders of NBC CapS – Series 1 may exchange, subject to prior notice, each NBC CapS – Series 1 for 40 First Preferred Shares, Series 17 of the Bank (Note 22). This exchange right will be effected through the conversion by the Trust of the corresponding amount of the deposit note of the Bank. The NBC CapS – Series 1 exchanged for the Bank's First Preferred Shares, Series 17 will be cancelled by the Trust.

(3) The Trust may, at its option, redeem the NBC CapS – Series 1, in whole or in part, on the date indicated above (and at any subsequent distribution date), or prior to that date in whole (but not in part) upon the occurrence of predetermined regulatory events or tax events. Any redemption may be carried out without the consent of the holders, subject to prior written notice and Superintendent approval.

(4) For each distribution date after June 30, 2016, the distribution will be paid at the rate corresponding to one-half of the applicable 180-day bankers' acceptance rate in effect plus 1.50%.

Automatic exchange

Each NBC CapS – Series 1 will be exchanged automatically, without the consent of the holders, for 40 First Preferred Shares, Series 18 of the Bank, upon the occurrence of certain specific events (for additional information, see Note 22). On an automatic exchange, the Bank will hold all outstanding trust capital securities of the Trust, the main asset of which is the deposit note.

Purchase for cancellation

On and after June 30, 2011, any outstanding NBC CapS II – Series 1 may be purchased at any time, in whole or in part, by the Trust, at the direction of the Bank and with Superintendent approval, in the open market or by tender or private contract at any price. The NBC CapS – Series 1 purchased by the Trust will be cancelled and will not be reissued.

Regulatory capital

The \$225 million in NBC CapS – Series 1 qualifies as innovative capital instruments and is therefore eligible as Tier 1 capital.

NOTE 18

FINANCIAL INSTRUMENTS DESIGNATED AS HELD-FOR-TRADING

Securities

During fiscal 2009, the Bank had designated the restructured notes of the MAV conduits with one or more embedded derivatives as *Held-for-trading securities* under the fair value option. For additional information, see Note 9. As at October 31, 2010, the fair value of these notes was \$1.1 billion (\$1.1 billion as at October 31, 2009). During fiscal 2010, the Bank received capital repayments related to the restructured notes of the MAV conduits, certain restructured notes were taken back from clients who had credit facilities backed by these notes, and certain notes were written off. No change in fair value was recorded in the Consolidated Statement of Income.

The Bank may also designate securities purchased to economically hedge certain derivative financial instruments as held-for-trading. The Bank may adopt this option in accordance with its risk management strategy, which allows it to manage these securities and the derivative financial instruments involved together using the fair value basis and thereby considerably reducing financial risks. During the year ended October 31, 2010, the Bank had not designated any securities under the fair value option (securities with an initial cost of \$2.7 billion for the year ended October 31, 2009). As at October 31, 2010, there were no other securities designated as held-for-trading, except for the previously described restructured notes of the MAV conduits. As at October 31, 2009, the fair value of securities designated as held-for-trading, other than the restructured notes, was \$2.7 billion. No fair value changes were recognized in *Trading revenues (losses)* in the Consolidated Statement of Income for the year ended October 31, 2010 (\$57 million gain for the year ended October 31, 2009).

Securities purchased under reverse repurchase agreements

During the year ended October 31, 2010, the Bank designated securities purchased under reverse repurchase agreements with an initial cost of \$84 million as held-for-trading, in accordance with its risk management strategy, which allows the Bank to eliminate or significantly reduce the measurement or recognition disparity of measuring financial assets and liabilities on different bases.

As at October 31, 2010, the total fair value of these financial instruments designated as held-for-trading was \$84 million. The change in fair value was negligible for the year ended October 31, 2010 and was recorded in *Trading revenues (losses)* in the Consolidated Statement of Income.

Deposits

Certain deposits with one or more embedded derivatives are designated as held-for-trading under the fair value option. These deposits are included under liabilities in *Deposits* in the Consolidated Balance Sheet. The fair value of these deposits was \$627 million as at October 31, 2010 (\$662 million as at October 31, 2009). The \$67 million change in fair value for the year ended October 31, 2010 (gain of \$72 million for the year ended October 31, 2009) was recorded as a loss in *Trading revenues (losses)* in the Consolidated Statement of Income. The change in fair value attributable to credit risk is an unrealized gain of \$5 million for the year ended October 31, 2010 (\$28 million unrealized loss for the year ended October 31, 2009).

To determine the change in fair value due to the change in credit risk for these financial liabilities, the Bank calculates, at the beginning of the period, the present value of the instrument's contractual cash flows using the following rates: first, using an observed discount rate that reflects the Bank's credit spread and, then, using a rate that excludes the Bank's credit spread. The difference between the two values is then compared to the difference obtained using the same rates at the end of the period.

The amount at maturity, which the Bank will be contractually required to pay to the holders of these deposits, may vary and will be different from the fair value as at October 31, 2010.

Securities sold under repurchase agreements

During the years ended October 31, 2010 and 2009, the Bank designated certain securities sold under repurchase agreements as held-for-trading, in accordance with its risk management strategy, which allows the Bank to eliminate or significantly reduce the measurement or recognition disparity of measuring assets and liabilities on different bases. These financial liabilities are fully collateralized with high-quality government bonds, and the change in fair value attributable to credit risk is not significant.

As at October 31, 2010, no securities sold under repurchase agreements were designated as held-for-trading. As at October 31, 2009, the total fair value of these financial instruments designated as held-for-trading was \$2.7 billion. The change in fair value was negligible for the years ended October 31, 2010 and 2009 and was recognized in *Trading revenues (losses)* in the Consolidated Statement of Income.

NOTE 19

OTHER LIABILITIES

As at October 31	2010	2009
Interest and dividends payable	475	476
Income taxes payable	163	343
Future income tax liabilities (Note 26)	163	150
Trade and other payables	466	737
Accrued benefit liability (Note 23)	153	145
Insurance-related obligations	67	62
Subsidiaries' debts to third parties	4,051	3,791
Accounts payable and deferred income	460	441
Other	565	478
	6,563	6,623

NOTE 20

SUBORDINATED DEBENTURES

Subordinated debentures represent direct unsecured obligations, in the form of notes and debentures, to the Bank's debt holders. The rights of the holders of the Bank's notes and debentures are subordinate to the claims of depositors and certain other creditors. Approval from the Superintendent is required before the Bank can redeem its subordinated debentures in whole or in part.

During the year ended October 31, 2009, the Bank repurchased for cancellation a total of \$250 million of subordinated debentures maturing on April 16, 2014.

As at October 31					2010	2009
Maturity date		Interest rate	Characteristics	Denominated in foreign currency		
November	2016	4.456% ⁽¹⁾	Redeemable ⁽²⁾		500	500
November	2018	5.55% ⁽³⁾	Redeemable ⁽⁴⁾		500	500
December	2019	4.926% ⁽⁵⁾	Redeemable ⁽⁶⁾		350	350
November	2020	4.70% ⁽⁷⁾	Redeemable ⁽⁸⁾		500	500
February	2087	Variable ⁽⁹⁾	Redeemable at the Bank's option since February 28, 1993	US 44	44	47
					1,894	1,897
Fair value adjustment ⁽¹⁰⁾					143	125
Unamortized issue costs ⁽¹¹⁾					(4)	(5)
Total					2,033	2,017

(1) Bearing interest at a rate of 4.456% until November 2, 2011, and thereafter at an annual rate equal to the 90-day bankers' acceptance rate plus 1%.

(2) The Bank may, at its option, redeem all or any portion of the debentures at the following price: (i) if the debentures are redeemed before November 2, 2011, the interest reset date, at the price based on the Government of Canada yield (defined as the yield, compounded semi-annually, that non-callable Government of Canada Bonds would offer if they were issued at their nominal value on the redemption date, in Canadian dollars, in Canada and for which the term to maturity would equal the term to the interest reset date) plus 12 basis points or the nominal value, whichever of the two amounts is higher; (ii) if the debentures are redeemed on or after November 2, 2011, at their nominal value.

(3) Bearing interest at a rate of 5.55% until November 15, 2013, and thereafter at an annual rate equal to the 90-day bankers' acceptance rate plus 2.64%.

(4) The Bank may, at its option, redeem all or any portion of the debentures at the following price: (i) if the debentures are redeemed before November 15, 2013, the interest reset date, at the price based on the Government of Canada yield (as defined in point 2 above) plus 55 basis points, or the nominal value, whichever of the two amounts is higher; (ii) if the debentures are redeemed on or after November 15, 2013, at their nominal value.

(5) Bearing interest at a rate of 4.926% until December 22, 2014, and thereafter at an annual rate equal to the 90-day bankers' acceptance rate plus 1%.

(6) The Bank may, at its option, redeem all or any portion of the debentures at the following price: (i) if the debentures are redeemed before December 22, 2014, the interest reset date, at the price based on the Government of Canada yield (as defined in point 2 above) plus 17 basis points or the nominal value, whichever of the two amounts is higher; (ii) if the debentures are redeemed on or after December 22, 2014, at their nominal value.

(7) Bearing interest at a rate of 4.70% until November 2, 2015, and thereafter at an annual rate equal to the 90-day bankers' acceptance rate plus 1%.

(8) The Bank may, at its option, redeem all or any portion of the debentures at the following price: (i) if the debentures are redeemed before November 2, 2015, the interest reset date, at the price based on the Government of Canada yield (as defined in point 2 above) plus 16 basis points or the nominal value, whichever of the two amounts is higher; (ii) if the debentures are redeemed on or after November 2, 2015, at their nominal value.

(9) Bearing interest at an annual rate of 1/8% above LIBOR.

(10) The fair value adjustment reflects the change in the carrying value of the subordinated debentures covered by a fair value hedge.

(11) The unamortized costs related to the issuance of the subordinated debentures represent the initial cost, net of accumulated amortization calculated using the effective interest rate method.

NOTE 20 SUBORDINATED DEBENTURES (cont.)

The subordinated debenture maturities are as follows:

2011 to 2015	—
2016 to 2020	1,850
2021 and thereafter	44
	1,894

NOTE 21

NON-CONTROLLING INTERESTS

As at October 31	2010	2009
Trust units issued by NBC Asset Trust (NBC CapS II)		
– Series 1	400	400
– Series 2	350	350
Mutual funds consolidated in accordance with AcG-15	199	91
Other entities consolidated in accordance with AcG-15	225	337
Other	25	19
Total	1,199	1,197

Trust units issued by NBC Asset Trust

The Bank issued non-voting transferable trust units called Trust Capital Securities or NBC CapS II through its subsidiary NBC Asset Trust (the Trust), a closed-end trust established under the laws of Ontario. These securities are not redeemable or exchangeable for Bank preferred shares at the option of the holder. The gross proceeds from the investments were used by the Trust to finance the acquisition of mortgage loans from the Bank.

No cash distributions will be payable by the Trust on NBC CapS II if the Bank fails to declare regular dividends on its preferred shares or, if no preferred shares are then outstanding, on its outstanding common shares. In this case, the net distributable funds of the Trust will be paid to the Bank as the sole holder of the special trust securities, representing the residual interest in the Trust. Should the Trust fail to pay the semi-annual distributions in full on the NBC CapS II, the Bank will withhold from declaring dividends on any of its preferred and common shares during a determined period.

The main terms and characteristics of the NBC CapS II trust units are presented below:

	Number	Issuance date	Annual yield	Distribution date	Semi-annual distribution per NBC CapS II ⁽¹⁾	Date of redemption at the option of the Trust ⁽²⁾
Series 1	400,000	January 22, 2008	7.235%	June 30, December 31	\$36.175 ⁽³⁾	June 30, 2013
Series 2	350,000	June 30, 2008	7.447%	June 30, December 31	\$37.235 ⁽⁴⁾	July 31, 2013

(1) For each unit with a nominal value of \$1,000.

(2) On the redemption date indicated above (or on any subsequent distribution date), or prior to those dates upon the occurrence of predetermined regulatory events or tax events, the Trust may, at its option, redeem the NBC CapS II in whole (but not in part) without the consent of the holders, with prior written notice and with Superintendent approval.

(3) For each distribution date after June 30, 2018, the distribution will be paid at the rate equal to one-half the 180-day bankers' acceptance rate in effect plus 3.79%.

(4) For each distribution date after June 30, 2020, the distribution will be paid at the rate corresponding to one-half the 180-day bankers' acceptance rate in effect plus 4.09%.

Automatic exchange

Each NBC CapS II – Series 1 can be exchanged automatically, without the consent of the holders, for 40 First Preferred Shares, Series 19 of the Bank, and each NBC CapS II – Series 2 can be exchanged automatically, without the consent of the holders, for 40 First Preferred Shares, Series 23 of the Bank, upon the occurrence of certain specific events. For additional information, see Note 22. On an automatic exchange, the Bank will hold all outstanding trust capital securities of the Trust.

NOTE 21 NON-CONTROLLING INTERESTS (cont.)

Purchases for cancellation

For each series, starting from the fifth anniversary of the issuance, the Trust will, with Superintendent approval, be able to purchase NBC CapS II in whole or in part on the open market or by tender or private contract at any price. The NBC CapS II purchased by the Trust will be cancelled and will not be reissued.

Regulatory capital

The NBC CapS II qualify as innovative instruments and are eligible as Tier 1 capital. According to the guidelines of the Superintendent, innovative instruments may consist of a portion representing up to 15% of net Tier 1 capital and an additional portion of 5% eligible as Tier 2B capital.

NOTE 22

CAPITAL STOCK

Authorized

Common shares

An unlimited number of shares without par value.

First preferred shares

An unlimited number of shares, without par value, issuable for a maximum aggregate consideration of \$5 billion.

Characteristics of first preferred shares (amounts in dollars)

Series 15

Redeemable in cash at the Bank's option, subject to prior approval of the Superintendent since May 15, 2008, in whole or in part, at a price equal to \$25.50 per share if redeemed during the 12-month period preceding May 15, 2011, at a price equal to \$25.25 per share if redeemed during the 12-month period preceding May 15, 2012, and at a price equal to \$25.00 per share if redeemed on or after May 15, 2012, plus, in all cases, all declared and unpaid dividends at the date fixed for redemption. These shares carry a non-cumulative quarterly dividend of \$0.365625.

Series 16

Redeemable in cash at the Bank's option, subject to prior approval of the Superintendent, since May 15, 2010, in whole or in part, at a price equal to \$26.00 per share if redeemed before May 15, 2011, at a price equal to \$25.75 per share if redeemed during the 12-month period preceding May 15, 2012, at a price equal to \$25.50 per share if redeemed during the 12-month period preceding May 15, 2013, at a price equal to \$25.25 per share if redeemed during the 12-month period preceding May 15, 2014, and at a price equal to \$25.00 per share if redeemed on or after May 15, 2014, plus, in all cases, all declared and unpaid dividends at the date fixed for redemption. These shares carry a non-cumulative quarterly dividend of \$0.303125.

Series 20

Redeemable in cash at the Bank's option, subject to prior approval of the Superintendent, on or after May 15, 2013, in whole or in part, at a price equal to \$26.00 per share if redeemed before May 15, 2014, at a price equal to \$25.75 per share if redeemed during the 12-month period preceding May 15, 2015, at a price equal to \$25.50 per share if redeemed during the 12-month period preceding May 15, 2016, at a price equal to \$25.25 per share if redeemed during the 12-month period preceding May 15, 2017, and at a price equal to \$25.00 per share if redeemed on or after May 15, 2017, plus, in all cases, all declared and unpaid dividends at the date fixed for redemption. These shares carry a non-cumulative quarterly dividend of \$0.375.

Series 21

Redeemable in cash at the Bank's option, subject to prior approval of the Superintendent, on or after August 16, 2013 and August 16 every five years thereafter, in whole or in part, at a price equal to \$25.00 per share, plus all declared and unpaid dividends at the date fixed for redemption. These shares carry a non-cumulative quarterly dividend of \$0.33594 for the initial period ending August 15, 2013. Thereafter, these shares carry a non-cumulative quarterly fixed dividend in an amount per share determined by multiplying the interest rate, equal to the sum of the Government of Canada yield on the calculation date of the applicable fixed rate plus 2.05%, by \$25.00.

NOTE 22 CAPITAL STOCK (cont.)

Series 24

Redeemable in cash at the Bank's option, subject to prior approval of the Superintendent, on or after February 15, 2014 and February 15 every five years thereafter, in whole or in part, at a price equal to \$25.00 per share, plus all declared and unpaid dividends at the date fixed for redemption. Convertible into floating-rate non-cumulative first preferred shares, Series 25 of the Bank, subject to certain conditions, on February 15, 2014 and on February 15 every five years thereafter. These shares carry a non-cumulative quarterly dividend of \$0.4125 for the initial period ending February 15, 2014. Thereafter, these shares carry a non-cumulative quarterly fixed dividend in an amount per share determined by multiplying the interest rate, equal to the sum of the Government of Canada yield on the calculation date of the applicable fixed rate plus 4.63%, by \$25.00.

Series 26

Redeemable in cash at the Bank's option, subject to prior approval of the Superintendent, on or after February 15, 2014 and February 15 every five years thereafter, in whole or in part, at a price equal to \$25.00 per share, plus all declared and unpaid dividends at the date fixed for redemption. Convertible into floating-rate non-cumulative first preferred shares, Series 27 of the Bank, subject to certain conditions, on February 15, 2014 and on February 15 every five years thereafter. These shares carry a non-cumulative quarterly dividend of \$0.4125 for the initial period ending February 15, 2014. Thereafter, these shares carry a non-cumulative quarterly fixed dividend in an amount per share determined by multiplying the interest rate, equal to the sum of the Government of Canada yield on the calculation date of the applicable fixed rate plus 4.79%, by \$25.00.

Characteristics of first preferred shares, authorized but unissued (amounts in dollars)

Series 17

Each NBC CapS – Series 1 is exchangeable at any time, upon prior notice, for 40 First Preferred Shares, Series 17 of the Bank. The Bank's First Preferred Shares, Series 17 pay semi-annual non-cumulative cash dividends and are redeemable at the Bank's option, subject to the prior approval of the Superintendent, on or after June 30, 2011, but are not redeemable at the option of the holders.

Series 18

Each NBC CapS – Series 1 can be exchanged automatically, without the consent of the holders, for 40 First Preferred Shares, Series 18 of the Bank, upon the occurrence of any one of the following events: (i) proceedings are commenced for the winding-up of the Bank; (ii) the Superintendent takes control of the Bank; (iii) the Bank has a Tier 1 capital ratio of less than 5% or a total capital ratio of less than 8%; or (iv) the Superintendent has directed the Bank to increase its capital or to provide additional liquidity and the Bank elects such automatic exchange or the Bank fails to comply with such direction to the satisfaction of the Superintendent. The Bank's First Preferred Shares, Series 18 pay semi-annual non-cumulative cash dividends and are redeemable at the option of the Bank, subject to the prior approval of the Superintendent, on or after June 30, 2011, but are not redeemable at the option of the holders.

Series 19

Each NBC CapS II – Series 1 can be exchanged automatically, without the consent of the holders, for 40 First Preferred Shares, Series 19 of the Bank upon the occurrence of one of the following events: (i) proceedings are commenced for the winding-up of the Bank; (ii) the Superintendent takes control of the Bank; (iii) the Bank posts a Tier 1 capital ratio of less than 5% or a total capital ratio of less than 8%; or (iv) the Superintendent has directed the Bank to increase its capital or to provide additional liquidity and the Bank elects to cause such automatic exchange or the Bank does not comply with such direction to the satisfaction of the Superintendent. The Bank's First Preferred Shares, Series 19 pay semi-annual non-cumulative cash dividends and are redeemable at the Bank's option, subject to the prior approval of the Superintendent, on or after June 30, 2013, but are not redeemable at the option of the holders.

Series 22

Holders of Preferred Shares Series 21 will, subject to the automatic conversion provisions and the right of the Bank to redeem those shares, have the right, at their option, to convert, on August 16, 2013 and on August 16 every five years thereafter, any or all of their Preferred Shares Series 21 into an equal number of Preferred Shares Series 22. First Preferred Shares Series 22 pay quarterly floating rate non-cumulative dividends and are redeemable at the Bank's option, subject to prior approval of the Superintendent, on or after August 16, 2018, but are not redeemable at the option of the holders.

Series 23

Each NBC CapS II – Series 2 can be exchanged automatically, without the consent of the holders, for 40 First Preferred Shares, Series 23 of the Bank upon the occurrence of one of the following events: (i) proceedings are commenced for the winding-up of the Bank; (ii) the Superintendent takes control of the Bank; (iii) the Bank posts a Tier 1 capital ratio of less than 5% or a total capital ratio of less than 8%; or (iv) the Superintendent has directed the Bank to increase its capital or to provide additional liquidity and the Bank elects to cause such automatic exchange or the Bank does not comply with such direction to the satisfaction of the Superintendent. The Bank's First Preferred Shares, Series 23 pay semi-annual non-cumulative cash dividends and are redeemable at the Bank's option, subject to the prior approval of the Superintendent, on or after July 31, 2013, but are not redeemable at the option of the holders.

NOTE 22 CAPITAL STOCK (cont.)

Series 25

Redeemable in cash at the Bank's option, subject to prior approval of the Superintendent, on or after February 15, 2019 and February 15 every five years thereafter, in whole or in part, at a price equal to \$25.00 per share, plus all dividends declared and unpaid thereon on the date fixed for redemption or at \$25.50 per share, plus all dividends declared and unpaid thereon on the date fixed for redemption on any other date on or after February 15, 2014.

Series 27

Redeemable in cash at the Bank's option, subject to prior approval of the Superintendent, on or after February 15, 2019 and February 15 every five years thereafter, in whole or in part, at a price equal to \$25.00 per share, plus all dividends declared and unpaid thereon on the date fixed for redemption or at \$25.50 per share, plus all dividends declared and unpaid thereon on the date fixed for redemption on any other date on or after February 15, 2014.

Second preferred shares

15 million shares without par value, issuable for total maximum consideration of \$300 million. As at October 31, 2010, no shares had been issued or traded.

Shares outstanding and dividends declared

As at October 31		2010	
	Number of shares	Shares	Dividends
		\$	\$ Per share
First Preferred Shares			
Series 15	8,000,000	200	12 1.4625
Series 16	8,000,000	200	10 1.2125
Series 20	6,900,000	173	10 1.5000
Series 21	8,050,000	201	11 1.3438
Series 24	6,800,000	170	11 1.6500
Series 26	5,800,000	145	9 1.6500
Preferred shares and dividends	43,550,000	1,089	63
Common shares at beginning	161,201,125	1,729	
Issued pursuant to:			
Dividend Reinvestment and Share Purchase Plan	513,058	29	
Stock Option Plan	877,577	44	
Impact of shares purchased or sold for trading	180,056	2	
Common shares at end and dividends	162,771,816	1,804	402 2.4800
Total dividends			465

As at October 31		2009	
	Number of shares	Shares	Dividends
		\$	\$ Per share
First Preferred Shares			
Series 15	8,000,000	200	12 1.4625
Series 16	8,000,000	200	10 1.2125
Series 20	6,900,000	173	10 1.5000
Series 21	8,050,000	201	11 1.3438
Series 24	6,800,000	170	9 1.3765
Series 26	5,800,000	145	7 1.3042
Preferred shares and dividends	43,550,000	1,089	59
Common shares at beginning	159,447,203	1,656	
Issued pursuant to:			
Dividend Reinvestment and Share Purchase Plan	590,864	29	
Stock Option Plan	906,457	42	
Impact of shares purchased or sold for trading	256,601	2	
Common shares at end and dividends	161,201,125	1,729	398 2.4800
Total dividends			457

NOTE 22 CAPITAL STOCK (cont.)

Issuances of preferred shares

On January 30, 2009, the Bank issued 4,000,000 First Preferred Shares, Series 26, with non-cumulative preferential dividends at a quarterly amount of \$0.4125 per share. The initial dividend was payable on May 15, 2009 and was \$0.47918 per share. Furthermore, the Bank granted the underwriters an over-allotment option to purchase up to an additional 3,000,000 shares at the exercise price of \$25.00 per share at any time in the 30 days following the closing date. The underwriters exercised this option by purchasing 1,800,000 Preferred Shares, Series 26. The Bank received a consideration of \$141 million, net of fees of \$4 million.

On January 14, 2009, the Bank issued 5,000,000 First Preferred Shares, Series 24, with non-cumulative preferential dividends at a quarterly amount of \$0.4125 per share. The initial dividend was payable on May 15, 2009 and was \$0.55151 per share. Furthermore, the Bank granted the underwriters an over-allotment option to purchase up to an additional 3,000,000 shares at the exercise price of \$25.00 per share at any time in the 30 days following the closing date. The underwriters exercised this option by purchasing 1,800,000 Preferred Shares, Series 24. The Bank received a consideration of \$165 million, net of fees of \$5 million.

Repurchase of common shares

On February 1, 2010, the Bank filed a normal course issuer bid to repurchase for cancellation up to 3,222,932 common shares over the 12-month period starting on February 1, 2010 and ending no later than January 31, 2011. The shares will be repurchased on the open market at market prices through the Toronto Stock Exchange. On February 1, 2008, the Bank had filed a normal course issuer bid to repurchase for cancellation up to 4,700,000 common shares over the 12-month period that ended January 30, 2009.

During the years ended October 31, 2010 and 2009, the Bank did not repurchase any shares.

Reserved common shares

As at October 31, 2010, 7,753,784 common shares were reserved under the Dividend Reinvestment and Share Purchase Plan and 12,770,585 common shares were reserved under the Stock Option Plan.

Common shares held in escrow

As part of the acquisitions of Bieber Securities Inc., concluded on June 2, 2008, and of Groupe Option Retraite Inc., concluded on September 18, 2008, the Bank had issued 452,650 common shares valued at \$24 million. Of that number, 161,995 common shares are placed in escrow in the name of the vendors and will be paid conditional on assets under management being maintained at a certain level. The Bank expects that the conditions will be met, and that the shares held in escrow will be released over the next year.

Restriction on the payment of dividends

The Bank is prohibited from declaring dividends on its common or preferred shares if there are reasonable grounds for believing that the Bank would, by so doing, be in contravention of the regulations of the *Bank Act* (Canada) or the guidelines of the Superintendent with respect to capital adequacy and liquidity. In addition, the ability to pay common share dividends is restricted by the terms of the outstanding preferred shares pursuant to which the Bank may not pay dividends on its common shares without the approval of the holders of the outstanding preferred shares, unless all preferred share dividends have been declared and paid or set aside for payment. If NBC Capital Trust or NBC Asset Trust failed to pay any required distribution on the trust units in full, the Bank could not declare dividends on any of its preferred or common shares. For additional information, see Notes 17 and 21.

Dividend Reinvestment Plan

The Bank has a dividend reinvestment plan for common and preferred shareholders. Participation in the plan is optional. Under the terms and conditions of the plan, participants acquire shares through the reinvestment of cash dividends paid on the shares they hold or through optional cash payments. The common shares are issued for an amount equal to the average of the closing prices of shares traded on the Toronto Stock Exchange during the five business days immediately preceding a dividend payment date.

NOTE 23

EMPLOYEE FUTURE BENEFITS

The Bank offers defined benefit pension plans that cover substantially all salaried employees. These defined benefit plans are funded pension plans. The effective dates of the most recent actuarial valuations and the next required actuarial valuations for funding purposes are:

	Date of most recent actuarial valuation	Date of required actuarial valuation
Employee pension plan	December 31, 2009	December 31, 2010
Pension plan for designated employees	December 31, 2009	December 31, 2010
Post-Retirement Allowance Program	December 31, 2008	December 31, 2010

The Bank's employee pension plans provide for the payment of benefits based on length of service and final average earnings of the employees covered by the plans. The Bank also offers various complementary, contributory insurance plans to eligible current and retired employees, their spouses and their dependants. However, these benefit plans are not funded. The measurement date used is October 31 of each year.

Accrued benefit obligation, plan assets and funded status

As at October 31	2010	2009	2010	2009
	Pension benefit plans		Other benefit plans	
Accrued benefit obligation				
Balance at beginning	1,884	1,645	149	141
Current service cost	41	34	5	5
Interest cost	128	120	10	10
Employee contributions	24	23	—	—
Benefits paid	(93)	(87)	(8)	(7)
Actuarial losses (gains)	139	149	2	—
Balance at end	2,123	1,884	158	149
Plan assets				
Fair value at beginning	2,051	1,617	—	—
Actual return on plan assets	209	203	—	—
Bank contributions	67	295	—	—
Employee contributions	24	23	—	—
Benefits paid	(93)	(87)	—	—
Fair value at end	2,258	2,051	—	—
Funded status — plan	135	167	(158)	(149)
Unamortized net actuarial losses	483	415	5	4
Unamortized past service costs	30	35	—	—
Accrued benefit asset (liability) at end	648	617	(153)	(145)

The previously presented amounts relate to the accrued benefit obligation and the fair value of plan assets at year-end. As at October 31, 2010 and 2009, the fair value of the assets in each pension plan was higher than the accrued benefit obligation.

E 23 EMPLOYEE FUTURE BENEFITS (cont.)

Accrued benefit asset (liability)

As at October 31	2010	2009	2010	2009
	Pension benefit plans		Other benefit plans	
Accrued benefit asset included in <i>Other assets</i>	648	617	–	–
Accrued benefit liability included in <i>Other liabilities</i>	–	–	(153)	(145)
Net amount recorded	648	617	(153)	(145)

Allocation of pension plan assets

As at October 31	2010	2009
	%	%
Asset category		
Money market	3	7
Bonds	38	33
Equities	53	54
Other	6	6
	100	100

Plan assets include investment securities issued by the Bank. As at October 31, 2010, these investments totalled \$118 million (\$120 million as at October 31, 2009).

During 2010, the Bank and its subsidiaries received close to \$4 million (\$3 million during 2009) in management fees for related management, administration and custodial services for pension benefit plans.

Components of employee future benefit expense

Year ended October 31	2010	2009	2010	2009
	Pension benefit plans		Other benefit plans	
Current service cost	41	34	5	5
Interest cost	128	120	10	10
Actual return on plan assets	(209)	(203)	–	–
Actuarial losses on the obligation	139	149	2	–
Expense before adjustments to recognize the long-term nature of employee future benefits	99	100	17	15
Difference between expected return and actual return on plan assets for the year	63	75	–	–
Difference between actuarial losses recognized for the year and actual actuarial losses on the accrued benefit obligation	(131)	(148)	(1)	1
Difference between amortization of past service costs for the year and the actual plan amendments for the year	6	6	–	–
Defined benefit pension expense	37	33		
Other employee future benefit expense			16	16

NOTE 23 EMPLOYEE FUTURE BENEFITS (cont.)

Significant actuarial assumptions (weighted average)

	2010	2009	2010	2009
	Pension benefit plans		Other benefit plans	
	%	%	%	%
Accrued benefit obligation as at October 31				
Discount rate	5.75	6.75	5.75	6.75
Rate of compensation increase	3.00	3.50	3.00	3.55
Defined benefit pension expense for years ended October 31				
Discount rate	6.75	7.25		
Expected long-term rate of return on plan assets	7.00	7.00		
Rate of compensation increase	3.50	3.50		
Other employee future benefit expense for years ended October 31				
Discount rate			6.75	7.25
Rate of compensation increase			3.55	3.50

The Bank also offers its employees certain post-retirement and post-employment benefits, compensated leave and termination benefits (non-pension employee benefits), and these programs are generally not funded. The benefits include health insurance, life insurance and dental insurance.

For measurement purposes, a 5.7% annual rate of increase in the per capita cost of covered healthcare benefits was assumed for 2010 (5.9% in 2009). The rate was assumed to decrease gradually to reach 2.5% in 2024 and remain at that level thereafter.

2010 sensitivity of key assumptions

	Change in obligation	Change in expense
Other benefit plans		
Impact of a 0.25% change in the assumption regarding the discount rate	5.2	0.2
Impact of a 0.25% change in the assumption regarding the rate of compensation increase	0.1	–
Impact of a 1.00% increase in the expected healthcare cost trend rate	16.1	1.7
Impact of a 1.00% decrease in the expected healthcare cost trend rate	(13.4)	(1.3)

The sensitivity analysis presented in the above table must be used with caution given that the changes are hypothetical and the changes in each significant assumption may not be linear.

Cash payments for employee future benefits

Year ended October 31	2010	2009
Bank pension benefit plan contributions	67	295
Benefits paid to beneficiaries under other benefit plans	8	7

The following table presents the estimates of the benefit payments for defined benefit plans and other plans.

Benefits payment projection

Year ended October 31	Pension benefit plans	Other benefit plans
2011	94	7
2012	97	8
2013	102	9
2014	109	9
2015	115	10
2016 to 2020	634	60

NOTE 24

STOCK-BASED COMPENSATION

The information below on compensation expense excludes the impact of hedging.

Stock Option Plan

The Bank offers a Stock Option Plan to officers and other designated persons of the Bank and its subsidiaries. Under the Plan, options are awarded annually and provide participants with the right to purchase common shares at an exercise price equal to the closing price of the common shares of the Bank on the Toronto Stock Exchange on the day preceding the award. The options vest evenly over a four-year period and expire 10 years from the award date or, in certain circumstances set out in the Plan, within specified time limits. Since March 1, 2009, the Stock Option Plan contains provisions for retiring employees that allow a participant's rights to continue vesting in accordance with the terms of the grant agreement. The maximum number of common shares that may be issued under the Stock Option Plan was 12,770,585 as at October 31, 2010 (13,648,162 as at October 31, 2009). The maximum number of common shares reserved for a participant may not exceed 5% of the total number of Bank shares issued and outstanding.

As at October 31	2010		2009	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Stock Option Plan				
Outstanding at beginning	7,798,096	\$48.19	6,711,730	\$52.00
Awarded	1,863,160	\$58.49	2,357,740	\$34.87
Exercised	(877,577)	\$41.67	(906,457)	\$39.44
Cancelled	(298,593)	\$54.11	(364,917)	\$53.83
Outstanding at end	8,485,086	\$50.92	7,798,096	\$48.19
Exercisable at end	3,751,890	\$52.62	3,184,406	\$51.14

Exercise price	Options outstanding	Options exercisable	Expiry date
\$24.90	41,650	41,650	December 2010
\$28.01	91,880	91,880	December 2011
\$30.95	148,450	148,450	December 2012
\$41.00	283,700	283,700	December 2013
\$48.20	418,975	411,475	December 2014
\$61.44	688,550	688,550	December 2015
\$65.90	1,147,123	862,669	December 2016
\$53.85	1,790,123	839,381	December 2017
\$34.87	2,070,423	384,135	December 2018
\$58.49	1,804,212	—	December 2019
Total	8,485,086	3,751,890	

During the year ended October 31, 2010, the Bank awarded 1,863,160 stock options (2,357,740 in 2009) with a fair value of \$10.96 per option (\$5.65 for the year ended October 31, 2009).

The fair value of options awarded was estimated on the award date using the discrete dividend Black-Scholes model. The following assumptions are used for accounting purposes:

As at October 31	2010	2009
Risk-free interest rate	2.85%	2.23%
Expected life of options	6 years	6 years
Expected volatility	29.5%	41.0%
Expected dividend yield	4.1%	7.1%

The compensation expense recorded for these options for the year ended October 31, 2010 was \$14 million (\$13 million for the year ended October 31, 2009).

NOTE 24 STOCK-BASED COMPENSATION (cont.)

Stock Appreciation Rights (SAR) Plan

The Bank offers an SAR Plan to officers and other designated persons of the Bank and its subsidiaries. Under the Plan, when participants exercise this right, they receive a cash amount equal to the difference between the closing price of the common shares of the Bank on the Toronto Stock Exchange on the day preceding the exercise date and the closing price on the day preceding the award date. SARs vest evenly over a four-year period and expire 10 years after the award date or, in certain circumstances set out in the Plan, within specified time limits. Since March 1, 2009, the SAR Plan contains provisions for retiring employees that allow a participant's rights to continue vesting in accordance with the stated terms of the grant agreement. Compensation expense recognized for the year ended October 31, 2010 with respect to the Plan was \$1 million (\$5 million for the year ended October 31, 2009).

As at October 31	2010		2009	
	Number of SARs	Weighted average exercise price	Number of SARs	Weighted average exercise price
SAR Plan				
Outstanding at beginning	171,174	\$42.30	329,404	\$29.67
Awarded	45,868	\$58.49	56,892	\$34.87
Exercised	(47,829)	\$26.03	(200,450)	\$18.01
Cancelled	(8,514)	\$48.83	(14,672)	\$61.95
Outstanding at end	160,699	\$51.41	171,174	\$42.30
Exercisable at end	47,657	\$56.39	67,651	\$37.89
	SARs outstanding	SARs exercisable	Expiry date	
\$48.20	3,350	3,350	December 2014	
\$61.44	2,300	2,300	December 2015	
\$65.90	28,293	21,326	December 2016	
\$53.85	31,146	13,608	December 2017	
\$34.87	49,742	7,073	December 2018	
\$58.49	45,868	—	December 2019	
Total	160,699	47,657		

Deferred Stock Unit (DSU) Plans

The DSU Plans are for officers and other designated persons of the Bank and its subsidiaries as well as directors. These Plans make it possible to tie a portion of the value of the compensation of participants to the future value of the Bank's common shares. A DSU is a right that has a value equal to the closing price of a common share of the Bank on the Toronto Stock Exchange on the day preceding the award. DSUs generally vest evenly over four years. Additional DSUs are credited to the account of participants equal in amount to the dividends paid on common shares of the Bank and vest evenly over the same period as the reference DSUs. DSUs may only be cashed when the participant retires or leaves the Bank, or for a director, when his term ends. The DSU Plan contains provisions for retiring employees that allow the participant's units to continue vesting in accordance with the stated terms of the grant agreement. During the year ended October 31, 2010, the Bank awarded 43,618 DSUs at a weighted average price of \$58.49 (64,502 DSUs at a weighted average price of \$34.87 for the year ended October 31, 2009). A total of 263,963 DSUs were outstanding as at October 31, 2010 (247,020 DSUs as at October 31, 2009). A compensation expense of \$6 million was recognized for the year ended October 31, 2010 with respect to the Plans (\$6 million for the year ended October 31, 2009).

NOTE 24 STOCK-BASED COMPENSATION (cont.)

Restricted Stock Unit (RSU) Plan

The RSU Plan is for certain officers and other designated persons of the Bank and its subsidiaries. The objective of the Plan is to ensure that the compensation of certain officers is competitive and to foster retention. An RSU is a right that has a value equal to the closing price of a common share of the Bank on the Toronto Stock Exchange on the day preceding the award. RSUs generally vest evenly over three years, although some RSUs vest on the last day of the 35th month following the date of the award, the date on which all RSUs expire. Additional RSUs are credited to the account of participants equal in amount to the dividends declared on the common shares of the Bank and vest evenly over the same period as the reference RSUs. The RSU Plan contains provisions for retiring employees that allow the participant's units to continue vesting in accordance with the stated terms of the grant agreement. During the year ended October 31, 2010, the Bank awarded 1,407,697 RSUs at a weighted average price of \$58.43 (715,816 RSUs at a weighted average price of \$34.87 for the year ended October 31, 2009). As at October 31, 2010, a total of 2,007,770 RSUs were outstanding (866,446 as at October 31, 2009). A compensation expense of \$75 million was recognized for the year ended October 31, 2010 with respect to the Plan (\$20 million for the year ended October 31, 2009).

Performance Stock Unit (PSU) Plan

The PSU Plan, implemented in 2009, is for certain members of senior management of the Bank. The objective of the Plan is to tie a portion of the value of the compensation of these members of senior management to the future value of the Bank's common shares. A PSU is a right that has a value equal to the closing price of a common share of the Bank on the Toronto Stock Exchange on the day preceding the award, adjusted upward or downward according to performance criteria, which is based on the total shareholder return (TSR) achieved by the Bank compared to that of the S&P/TSX Banks Sub-index. PSUs vest on the last day of the 35th month following the date of the award, the date on which all PSUs expire. Additional PSUs are credited to the account of participants in an amount equal to the dividends declared on the common shares of the Bank and vest evenly over the same period as the reference PSUs. The PSU Plan contains provisions for retiring employees that allow the participant's units to continue vesting in accordance with the stated terms of the award agreement. During the year ended October 31, 2010, the Bank awarded 84,962 PSUs at a weighted average price of \$58.49. As at October 31, 2010, a total of 87,652 PSUs were outstanding. A compensation expense of \$2 million was recognized for the year ended October 31, 2010 with respect to the Plan.

Deferred Compensation Plan of National Bank Financial (NBF)

This Plan is exclusively for key employees of Individual Investor Services of National Bank Financial (NBF). The purpose of the Plan is to foster the retention of key employees and promote the growth in income and the continuous improvement in profitability at Individual Investor Services. Under the Plan, participants can defer a portion of their annual compensation and NBF may pay a contribution to key employees when certain financial objectives are met. Amounts awarded by NBF and the compensation deferred by participants are invested in, among others, Bank stock units. These stock units represent a right, the value of which corresponds to the closing price of the common shares of the Bank on the Toronto Stock Exchange on the award date. Additional units are paid to the participant's account equal in amount to the dividends declared on the common shares of the Bank. Stock units representing the amounts awarded by NBF vest evenly over four years. When a participant retires, or in certain cases when the participant's employment is terminated, the participant receives a cash amount representing the value of the vested stock units. During the year ended October 31, 2010, NBF awarded 39,152 stock units at a weighted average price of \$59.72 (65,392 stock units at a weighted average price of \$46.69 for the year ended October 31, 2009). As at October 31, 2010, 406,002 units were outstanding (404,707 as at October 31, 2009). During the year ended October 31, 2010, a \$4 million compensation expense was recognized for this Plan (\$7 million for the year ended October 31, 2009).

Employee Share Ownership Plan

Under the Bank's Employee Share Ownership Plan, employees who meet the eligibility criteria can contribute up to 8% of their annual gross salary by way of payroll deductions. The Bank matches 25% of the employee contribution amount, to a maximum of \$1,500 per annum. Bank contributions vest to the employee after one year of continuous participation in the Plan. Subsequent contributions vest immediately. The Bank's contributions, amounting to \$7 million during the year ended October 31, 2010 (\$7 million for the year ended October 31, 2009), were charged to *Salaries and staff benefits* when paid. As at October 31, 2010, a total of 2,934,757 common shares were held for this Plan (3,027,384 common shares as at October 31, 2009).

Plan shares are purchased on the open market and are considered to be outstanding for earnings per share calculations. Dividends paid on the Bank's common shares held for the Employee Share Ownership Plan are used to purchase other common shares on the open market.

NOTE 25

RESTRUCTURING CHARGES

During fiscal 2010, National Bank Financial, a subsidiary of the Bank, began restructuring certain operations, the objective being to improve and concentrate certain activities in market segments identified as key segments. The reorganization will be finalized in the first quarter of 2011.

As at October 31, 2010, the Bank recorded a \$22 million restructuring charge in the Consolidated Statement of Income. The charge consists essentially of severance pay and professional fees incurred to implement the reorganization and are presented in the Financial Markets segment.

As at October 31, 2008, the Bank had recorded a \$66 million restructuring charge in the Consolidated Statement of Income for a reorganization that was implemented to align the Bank's distribution models and operations with client needs and to simplify processes and increase the efficiency of corporate functions. These charges had been presented under the *Other* heading of the segment disclosures. The reorganization was completed in fiscal 2009 with the final payments being made in the year ended October 31, 2010.

Year ended October 31	2010			2009
	Severance pay	Other charges	Total	Total
Balance at beginning of year	10	–	10	61
Restructuring charges	21	1	22	–
Payments made during the year	(10)	–	(10)	(51)
Balance at end of year	21	1	22	10

NOTE 26

INCOME TAXES

The Bank's income taxes presented in the consolidated financial statements for the years ended October 31 are as follows:

	2010	2009
Consolidated Statement of Income		
Current income taxes	221	169
Future income taxes relating to the inception and reversal of temporary differences	–	83
	221	252
Consolidated Statement of Changes in Shareholders' Equity		
Income taxes related to:		
Dividends on First Preferred Shares, Series 15, 16, 20, 21, 24 and 26	(2)	(15)
Share issuance and other expenses	–	(2)
Other comprehensive income	66	133
	64	116
Total income taxes	285	368

Income taxes for the years ended October 31 are as follows:

	2010	2009
Current income taxes	285	287
Future income taxes relating to the inception and reversal of temporary differences	–	81
Income taxes	285	368

TEMPORARY DIFFERENCES

The temporary differences and carryforwards resulting in future income tax assets and liabilities are as follows:

As at October 31	2010	2009
Future income tax assets		
Allowance for credit losses and other liabilities	339	296
Accrued benefit liability – Other benefit plans	41	39
Other comprehensive income	7	2
	387	337
Future income tax liabilities		
Premises and equipment	(84)	(44)
Securitization	(96)	(86)
Accrued benefit asset – Pension benefit plans	(167)	(162)
Other	(101)	(104)
	(448)	(396)
Net balance of future income tax assets (liabilities)	(61)	(59)

Net future income tax assets are included in *Other assets* and net future income tax liabilities are included in *Other liabilities*.

As at October 31	2010	2009
Future income tax assets	102	91
Future income tax liabilities	(163)	(150)
	(61)	(59)

Reconciliation of the Bank's income tax rate for the years ended October 31 is as follows:

	2010		2009	
	\$	%	\$	%
Income before income taxes and non-controlling interests	1,323	100.0	1,164	100.0
Income taxes at Canadian statutory income tax rate	410	31.0	372	32.0
Reduction in income tax rate due to:				
Tax-exempt income from securities, mainly dividends from Canadian corporations	(149)	(11.3)	(91)	(7.8)
Capital gains	–	–	(8)	(0.7)
Rates applicable to subsidiaries and foreign entities	(8)	(0.6)	(45)	(3.9)
Other items	(32)	(2.4)	24	2.1
	(189)	(14.3)	(120)	(10.3)
Income taxes reported in the Consolidated Statement of Income and effective income tax rate	221	16.7	252	21.7

NOTE 27

EARNINGS PER SHARE

Diluted earnings per share are calculated based on net income available to common shareholders divided by the weighted average number of common shares outstanding, taking into account the dilution effect of stock options using the treasury stock method.

Year ended October 31	2010	2009
Earnings per common share – Basic		
Net income	1,034	854
Dividends on preferred shares	63	59
Net income available to common shareholders	971	795
Average basic number of common shares outstanding (thousands)	162,054	160,263
Earnings per common share – Basic	\$5.99	\$4.96
Earnings per common share – Diluted		
Net income available to common shareholders	971	795
Average basic number of common shares outstanding (thousands)	162,054	160,263
Adjustment to average number of common shares (thousands)		
Stock options	1,283	638
Weighted average diluted number of common shares outstanding (thousands)	163,337	160,901
Earnings per common share – Diluted	\$5.94	\$4.94

For the year ended October 31, 2010, the calculation of the diluted earnings per share excluded 2,171,419 average options outstanding with a weighted average exercise price of \$63.22 (4,404,663 average options outstanding with a weighted average exercise price of \$57.11 for the year ended October 31, 2009) as the exercise price of these options was greater than the average price of the Bank's common shares.

NOTE 28

GUARANTEES, COMMITMENTS AND CONTINGENT LIABILITIES

Guarantees

The guarantees are obligations that meet the definition of a guarantee under AcG-14.

The maximum potential amount of future payments represents the maximum risk of loss if there were a total default by the guaranteed parties, without consideration of recoveries under recourse provisions, insurance policies or from collateral held or pledged. The maximum potential amount of future payments for significant guarantees issued by the Bank and in effect as at October 31 is presented in the following table:

	2010	2009
Letters of guarantee	2,252	2,362
Backstop liquidity and credit enhancement facilities	1,143	449
Derivative financial instruments	265	361
Securities lending	320	610
Other guarantee	33	32

Letters of guarantee

In the normal course of business, the Bank issues letters of guarantee. These letters of guarantee represent irrevocable commitments that the Bank will make payments in the event that a client cannot meet its financial obligations to third parties. The Bank's policy for requiring collateral security with respect to letters of guarantee is similar to that for loans. Generally, the term of these letters of guarantee is less than two years. The general allowance for credit losses covers all credit risks, including those relating to letters of guarantee.

Backstop liquidity and credit enhancement facilities

The Bank administers a multi-seller conduit that purchases various financial assets from clients and funds these purchases by issuing asset-backed commercial paper. The Bank provides a backstop liquidity facility to this multi-seller conduit. As at October 31, 2010, the committed notional amount of the global-style backstop liquidity facility totalled \$1.1 billion (\$489 million as at October 31, 2009), representing the total amount of the commercial paper outstanding.

This backstop liquidity facility can be drawn if the program is unable to access the commercial paper market, even if there is no general market disruption. This facility has a term of less than one year and can be periodically renewed. The terms and conditions of this backstop liquidity facility do not require the Bank to advance money to the conduit if the conduit is insolvent or involved in bankruptcy proceedings or to fund non-performing assets beyond the amount of the available credit enhancement. The backstop liquidity facility provided by the Bank has not been drawn to date.

Since May 2009, the Bank has provided a credit enhancement facility to this multi-seller conduit that is limited to certain assets. This facility has a term of less than one year and is automatically renewable unless the Bank sends a non-renewal notice. As at October 31, 2010, the committed notional value for this facility was \$30 million. This credit enhancement facility provided by the Bank has not been drawn to date.

The maximum risk of loss for the Bank cannot exceed the total amount of commercial paper outstanding. As at October 31, 2010, the Bank held \$5 million (\$40 million as at October 31, 2009) of this commercial paper and, consequently, the maximum potential amount of future payments was \$1.1 billion (\$449 million as at October 31, 2009).

NOTE 28 GUARANTEES, COMMITMENTS AND CONTINGENT LIABILITIES (cont.)

Derivative financial instruments

In the normal course of business, the Bank enters into written put options to meet the needs of its clients and for its own risk management and trading activities. Put options are contractual agreements whereby the Bank conveys to the purchaser the right, but not the obligation, to sell to the Bank by or before a predetermined date, a specific amount of currency, commodities or financial instruments, at a price agreed to when the option is sold. Written put options that qualify as a guarantee under AcG-14 include primarily over-the-counter currency options with companies other than financial institutions and over-the-counter stock options when it is probable that the counterparty holds the underlying securities. Most of the terms of these options vary according to the contracts, but do not generally exceed two years. As at October 31, 2010, the Bank recorded a liability of \$12 million in the Consolidated Balance Sheet with respect to these written put options (\$12 million as at October 31, 2009), representing their fair value.

Securities lending

Under securities lending agreements the Bank has entered into with certain clients who have entrusted it with the safekeeping of their securities, the Bank lends securities to third parties and indemnifies these clients in the event of loss. In order to protect itself against any contingent loss, the Bank obtains, as security from the borrower, a cash amount or extremely liquid marketable securities with a fair value greater than that of the securities loaned. No amount has been accrued in the Consolidated Balance Sheet with respect to potential indemnities resulting from these securities lending agreements.

Other indemnification agreements

In the normal course of business, including securitization activities and discontinuance of operations and activities, the Bank enters into numerous contractual agreements. Under these agreements, the Bank undertakes to compensate the counterparty for costs incurred as a result of litigation, changes in laws and regulations (including tax legislation), claims with respect to past performance, incorrect representations or the non-performance of certain restrictive covenants. The Bank also undertakes to indemnify any person acting as a director or officer or performing a similar function within the Bank or one of its subsidiaries or another entity, at the request of the Bank, for all expenses incurred by that person in proceedings or investigations to which he or she is party in that capacity. Moreover, as a member of a securities transfer network and pursuant to the membership agreement and the regulations governing the operation of the network, the Bank granted a movable hypothec to the network that can be used in the event another member fails to meet its contractual obligations. The durations of the indemnification agreements vary according to circumstance; as at October 31, 2010, given the nature of the agreements, the Bank is unable to make a reasonable estimate of the maximum potential liability it could be required to pay to counterparties. No amount has been recorded in the Consolidated Balance Sheet with respect to these agreements.

Other guarantee

Pursuant to a mutual guarantee agreement required by a regulatory authority, a subsidiary of the Bank has agreed to guarantee all commitments, debts and liabilities of a company subject to significant influence to the maximum of its regulatory capital. This guarantee expires no later than the date the investment in the company subject to significant influence is sold, or sooner if deemed appropriate by the regulatory authority. To date, this guarantee remains undrawn and no amount has been accrued in the Consolidated Balance Sheet with respect to this agreement.

Restructuring of certain asset-backed commercial paper conduits (ABCP)

Margin funding facilities

Following the events of 2007 in the third-party ABCP market, a Pan-Canadian restructuring plan was finalized on January 21, 2009. ABCP was replaced by restructured notes of the master asset vehicle (MAV) conduits. To support the restructuring plan, the Bank committed to contribute \$911 million to the margin funding facilities. Note 9 to the consolidated financial statements provides additional information on this topic.

Credit facilities to clients holding restructured notes of the master asset vehicle (MAV) conduits

In 2008, the Bank offered improved credit facilities to commercial and corporate clients holding restructured notes of the MAV conduits for their liquidity needs. These credit facilities cover up to 75% of the face value of the notes. The credit agreements also provide for an option in favour of the borrower allowing the borrower to assign to the Bank, on or after the maturity date of the credit facility, the restructured notes in payment of the principal of the credit facility. These credit facilities are available for a period of two to three years with the possibility of being extended by the Bank if borrowers maintain a normal banking relationship with the Bank during the period of the credit facility. As at October 31, 2010, improved credit facilities outstanding stood at \$143 million (\$285 million as at October 31, 2009). The amount of the credit facilities offered to clients, backed by IA tracking notes, was estimated at \$149 million as at October 31, 2010 (\$224 million as at October 31, 2009). The amount of the credit facilities offered to clients, backed by the restructured notes of the MAV conduits, was estimated at \$538 million as at October 31, 2010 (\$743 million as at October 31, 2009). For additional information, see Note 9.

NOTE 28 GUARANTEES, COMMITMENTS AND CONTINGENT LIABILITIES (cont.)

Commitments

The Bank has minimum future commitments under leases for premises, equipment and furniture, contracts for outsourced IT services and other contracts. The majority of these commitments are related to operating leases.

As at October 31, 2010, the minimum future⁽¹⁾ commitments are as follows:

2011	533
2012	433
2013	305
2014	240
2015	185
2016 and thereafter	564
	2,260

(1) An amount of \$7 million in imputed interest on a capital lease is included in minimum future commitments.

Pledged assets

In the normal course of business, the Bank pledges securities and other assets as collateral for various liabilities it incurs. A breakdown of assets pledged as collateral is provided in the table below. These transactions are concluded in accordance with standard terms and conditions for such transactions.

As at October 31	2010	2009
Assets pledged to		
Bank of Canada	25	30
Direct clearing organizations	31,859	30,223
Assets pledged in relation to		
Derivative financial instrument transactions	566	572
Borrowing, securities lending and securities sold under repurchase agreements	28,976	21,755
Other	125	99
Total	61,551	52,679

Financial assets received as collateral

As at October 31, 2010, the fair value of financial assets received as collateral that the Bank was authorized to sell or repledge totalled \$30 billion (\$20 billion as at October 31, 2009). These financial assets received as collateral were obtained as a result of transactions involving securities purchased under reverse repurchase agreements, borrowing and securities lending agreements, and derivative financial instrument transactions. These transactions are concluded in accordance with standard terms and conditions for such transactions.

NOTE 28 GUARANTEES, COMMITMENTS AND CONTINGENT LIABILITIES (cont.)

Credit instruments

In the normal course of business, the Bank enters into various off-balance sheet commitments. The credit instruments used to meet the financing needs of its clients represent the maximum amount of additional credit the Bank could be obligated to extend if the commitments were fully drawn.

As at October 31	2010	2009
Letters of guarantee ⁽¹⁾	2,252	2,362
Documentary letters of credit ⁽²⁾	69	62
Credit card receivables ⁽³⁾	5,627	6,393
Commitments to extend credit ⁽³⁾		
Original term of one year or less	12,272	15,501
Original term over one year	11,620	7,569

(1) See *Letters of guarantee*, page 158.

(2) Documentary letters of credit are documents issued by the Bank and used in international trade to enable a third party to draw drafts on the Bank up to an amount established under specific terms and conditions; these instruments are collateralized by the delivery of goods to which they are related.

(3) Credit card receivables and commitments to extend credit represent the undrawn portions of credit authorizations granted in the form of loans, acceptances, letters of guarantee and documentary letters of credit. The Bank is required at all times to make the undrawn portion of the authorization available, subject to certain conditions.

Other commitments

The Bank acts as an investor in investment banking activities where it enters into agreements to finance external private equity funds and investments in equity and debt securities at market value at the time the agreements are signed. In connection with these activities, the Bank had commitments to invest up to \$116 million as at October 31, 2010 (\$117 million as at October 31, 2009).

Litigation

In the normal course of their business, the Bank and its subsidiaries are involved in various claims, including, in particular, court proceedings, investigations or claims of a regulatory nature, class actions or other legal remedies of varied natures. Several of the court proceedings are related to lending activities, which occur, in particular, when the Bank takes steps to recover its claims.

The Bank is also more specifically involved as a defendant in class actions instituted by consumers who contest, inter alia, certain transaction fees and the unsolicited increase of credit card limits or who wish to avail themselves of certain provincial legislative provisions relating to consumer protection. All of these involve several complex issues and their resolution could thus extend over several years. These class actions are defended vigorously by the Bank, which has serious grounds of contestation.

Even though it is impossible to determine the outcome of the claims instituted or which may be instituted against the Bank and its subsidiaries, the Bank considers that, according to the information at its disposal, while the amount of contingent liabilities pertaining thereto, taken individually or in the aggregate, could have an impact on its operating income for a particular year, it would not have a material adverse impact on the Bank's consolidated financial position.

NOTE 29

DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are financial contracts whose value is derived from an underlying interest rate, exchange rate, or equity, commodity or credit instrument or index.

The main types of derivative financial instruments used are as follows:

Forwards and futures

Forwards and futures are contractual obligations to buy or deliver a specified amount of currency, interest rates, commodities or financial instruments on a specified future date at a specified price. Forwards are tailor-made agreements transacted in the over-the-counter market. Futures are traded on organized exchanges and are subject to cash margining calculated daily by clearing houses.

Swaps

Swaps are over-the-counter contracts in which two parties agree to exchange cash flows. The Bank uses the following types of swap contracts:

- Cross-currency swaps are transactions in which counterparties exchange fixed rate interest payments and principal payments in different currencies;
- Interest rate swaps are transactions in which counterparties exchange fixed and floating rate interest payments, based on the notional principal value in the same currency;
- Commodity swaps are transactions in which counterparties exchange fixed and floating rate payments, based on the notional principal value of a single product;
- Equity swaps are transactions in which counterparties agree to exchange the return on one equity or group of equities for a payment based on a benchmark interest rate; and
- Credit default swaps are transactions in which one of the parties agrees to pay interest expenses to the other party so that the latter can make a payment if a credit event occurs.

Options

Options are agreements between two parties in which the writer of the option conveys to the buyer the right, but not the obligation, to buy or sell, at or by a predetermined date, at any time prior to a predetermined expiry date, a specific amount of currency, commodities or financial instruments at a price agreed to when the option is sold. The writer receives a premium for selling this instrument.

NOTE 29 DERIVATIVE FINANCIAL INSTRUMENTS (cont.)

Notional amounts

Notional amounts are not presented in assets or liabilities in the Consolidated Balance Sheet. They represent the set underlying principal of a derivative financial instrument and serve as a point of reference in applying an exchange rate, interest rate, stock market price or other variable in order to determine the amount of cash flows to be exchanged. Notional amounts are presented in the following table:

As at October 31						2010	2009	
Term to maturity								
	Less than 3 months	3 to 12 months	1 to 5 years	More than 5 years	Total contracts	Contracts held for trading purposes	Contracts designated as hedges	Total contracts
INTEREST RATE CONTRACTS								
OTC contracts								
Guaranteed interest rate contracts	3,000	24,167	77	866	28,110	28,110	–	28,977
Swaps	41,836	51,812	101,218	35,016	229,882	208,426	21,456	186,302
Options purchased	272	2,094	37	84	2,487	2,487	–	3,885
Options written	262	6,131	201	198	6,792	6,792	–	914
Total	45,370	84,204	101,533	36,164	267,271	245,815	21,456	220,078
Exchange-traded contracts								
Futures								
Long positions	655	4,829	2,013	–	7,497	7,497	–	8,276
Short positions	4,252	7,378	557	–	12,187	12,187	–	8,858
Options purchased	10,347	5,894	6,121	–	22,362	22,362	–	30,185
Options written	11,412	10,317	6,121	–	27,850	27,850	–	24,509
Total	26,666	28,418	14,812	–	69,896	69,896	–	71,828
FOREIGN EXCHANGE CONTRACTS								
OTC contracts								
Forwards	5,041	1,058	606	–	6,705	6,705	–	7,409
Swaps	29,740	8,530	6,318	4,294	48,882	48,751	131	40,603
Options purchased	2,460	835	588	–	3,883	3,883	–	2,597
Options written	1,480	803	601	–	2,884	2,884	–	2,587
Total	38,721	11,226	8,113	4,294	62,354	62,223	131	53,196
Exchange-traded contracts								
Futures								
Long positions	155	–	–	–	155	155	–	913
Short positions	1	–	–	–	1	1	–	487
Options purchased	21	–	–	–	21	21	–	1,136
Options written	29	–	–	–	29	29	–	2,187
Total	206	–	–	–	206	206	–	4,723
EQUITY, COMMODITY AND CREDIT DERIVATIVE CONTRACTS								
OTC contracts								
Forwards	29	91	64	36	220	220	–	116
Swaps	4,248	11,970	23,636	5,295	45,149	45,121	28	40,171
Options purchased	505	459	847	52	1,863	1,863	–	1,590
Options written	125	447	733	17	1,322	1,322	–	1,229
Total	4,907	12,967	25,280	5,400	48,554	48,526	28	43,106
Exchange-traded contracts								
Futures								
Long positions	2,131	1,059	144	–	3,334	3,334	–	3,158
Short positions	4,074	1,098	546	–	5,718	5,718	–	3,636
Options purchased	694	810	544	4	2,052	2,052	–	1,813
Options written	199	154	1	–	354	354	–	1,405
Total	7,098	3,121	1,235	4	11,458	11,458	–	10,012
Total 2010	122,968	139,936	150,973	45,862	459,739	438,124	21,615	
Total 2009	91,920	144,839	129,993	36,191	402,943	388,505	14,438	402,943

NOTE 29 DERIVATIVE FINANCIAL INSTRUMENTS (cont.)

Credit risk

Credit risk on derivative financial instruments is the risk of financial loss that the Bank will have to assume if a counterparty fails to honour its contractual obligations. Credit risk related to derivative financial instruments is subject to the same credit approval, credit limit and monitoring standards as those applied to the Bank's other credit transactions. Consequently, the Bank evaluates the creditworthiness of counterparties, and monitors the size of the portfolios as well as the diversification and maturity profiles of these financial instruments.

The Bank limits the credit risk of over-the-counter contracts by dealing with creditworthy counterparties and through contracts that provide for the exchange of collateral between parties where the fair value of the outstanding transactions exceeds an agreed threshold. The Bank also negotiates master netting agreements that provide for the simultaneous close-out and settling of all transactions with a given counterparty in the event of default. However, overall exposure to credit risk, reduced through master netting agreements, may change substantially after the balance sheet date because it is affected by all transactions subject to a contract as well as by changes in the market rates of the underlying instruments.

In the case of exchange-traded contracts, exposure to credit risk is limited because these transactions are standardized contracts executed on established exchanges, each of which is associated with a well-capitalized clearing house that assumes the obligations of both counterparties and guarantees their performance obligations. All exchange-traded contracts are subject to initial margins and daily settlement.

Terms used in the following credit risk table

Current replacement cost

The current replacement cost represents the Bank's maximum credit risk associated with derivative financial instruments as at the Consolidated Balance Sheet date. This amount is the positive fair value of all over-the-counter derivative financial instruments, before all master netting agreements and collateral held.

Credit risk equivalent

The credit risk equivalent amount is the total current replacement cost plus an amount representing the potential future credit risk exposure, as outlined in the guidelines issued by the Superintendent.

Risk-weighted amount

The risk-weighted amount represents the credit risk equivalent multiplied by the risk-weighted factor for each counterparty, as outlined in the guidelines issued by the Superintendent.

As at October 31, the credit risk exposure of the derivative financial instrument portfolio, both before and after the impact of master netting agreements, was as follows:

	2010			2009		
	Current replacement cost ⁽¹⁾	Credit risk equivalent	Risk-weighted amount	Current replacement cost ⁽¹⁾	Credit risk equivalent	Risk-weighted amount
Interest rate contracts	3,931	4,935	2,046	3,404	4,248	970
Foreign exchange contracts	803	1,971	659	1,018	2,095	736
Equity, commodity and credit derivative contracts	3,144	6,274	1,486	2,760	6,189	3,377
	7,878	13,180	4,191	7,182	12,532	5,083
Impact of master netting agreements	(3,709)	(5,844)	(2,134)	(3,783)	(5,805)	(1,361)
	4,169	7,336	2,057	3,399	6,727	3,722

(1) As at October 31, 2010, the total positive fair value of the excluded exchange-traded contracts amounted to \$0.2 billion (\$0.3 billion as at October 31, 2009).

As at October 31, the credit risk exposure by counterparty was as follows:

	2010		2009	
	Replacement cost	Credit risk equivalent	Replacement cost	Credit risk equivalent
OECD governments ⁽¹⁾	152	515	138	479
Banks of OECD member countries ⁽¹⁾	1,013	2,958	1,047	2,634
Other	3,004	3,863	2,214	3,614
Total	4,169	7,336	3,399	6,727

(1) Organization for Economic Co-operation and Development.

NOTE 29 DERIVATIVE FINANCIAL INSTRUMENTS (cont.)

As at October 31, the fair values of derivative financial instruments were as follows:

	2010			2009		
	Positive	Negative	Net	Positive	Negative	Net
CONTRACTS HELD-FOR-TRADING PURPOSES						
Interest rate contracts						
Forwards	4	9	(5)	12	9	3
Swaps	3,066	3,163	(97)	2,676	2,846	(170)
Options	8	25	(17)	10	21	(11)
Total	3,078	3,197	(119)	2,698	2,876	(178)
Foreign exchange contracts						
Forwards	68	90	(22)	102	85	17
Swaps	689	601	88	862	641	221
Options	60	91	(31)	63	106	(43)
Total	817	782	35	1,027	832	195
Equity, commodity and credit derivative contracts						
Forwards	174	266	(92)	192	276	(84)
Swaps	2,922	1,894	1,028	2,459	1,516	943
Options	318	279	39	422	359	63
Total	3,414	2,439	975	3,073	2,151	922
Total – Contracts held-for-trading purposes	7,309	6,418	891	6,798	5,859	939
CONTRACTS DESIGNATED AS HEDGES						
Interest rate contracts						
Forwards	–	–	–	–	–	–
Swaps	809	213	596	718	48	670
Options	–	–	–	–	–	–
Total	809	213	596	718	48	670
Foreign exchange contracts						
Forwards	–	–	–	–	–	–
Swaps	1	–	1	–	–	–
Options	–	–	–	–	–	–
Total	1	–	1	–	–	–
Equity, commodity and credit derivative contracts						
Forwards	–	–	–	–	–	–
Swaps	1	–	1	–	40	(40)
Options	–	–	–	–	–	–
Total	1	–	1	–	40	(40)
Total – Contracts designated as hedges	811	213	598	718	88	630
Designated as fair value hedges	339	194	145	269	35	234
Designated as cash flow hedges	472	19	453	449	53	396
Total fair value	8,120	6,631	1,489	7,516	5,947	1,569
Impact of master netting agreements	(3,709)	(3,709)	–	(3,783)	(3,783)	–
	4,411	2,922	1,489	3,733	2,164	1,569

NOTE 30

INTEREST RATE SENSITIVITY POSITION

The Bank offers a range of financial products whose cash flows are sensitive to interest rate fluctuations. Interest rate risk arises from on- and off-balance sheet cash flow mismatches. The degree of exposure is based on the size and direction of interest rate movements and on the extent of the mismatch of the maturities. Analyzing interest rate sensitivity gaps is one of the techniques used by the Bank to manage interest rate risk.

The following table illustrates the sensitivity of the Bank's Consolidated Balance Sheet to interest rate fluctuations as at October 31.

	2010						2009	
	Floating rate	Less than 3 months	3 to 12 months	1 to 5 years	More than 5 years	Non-interest sensitive	Total	Total
Assets								
Cash	—	—	—	—	—	261	261	296
Deposits with financial institutions	75	532	7	7	—	1,392	2,013	1,932
Effective yield		0.7%	4.3%	4.7%	—			
Securities	167	3,036	9,482	10,303	9,163	22,117	54,268	50,233
Effective yield		1.0%	1.0%	2.1%	3.5%			
Loans	631	48,596	5,951	9,052	634	3,202	68,066	60,274
Effective yield		2.3%	4.1%	4.8%	5.9%			
Other assets	7,046	—	—	—	—	13,647	20,693	19,403
	7,919	52,164	15,440	19,362	9,797	40,619	145,301	132,138
Liabilities and shareholders' equity								
Deposits	3,115	35,589	14,507	21,163	946	6,465	81,785	75,170
Effective yield		1.4%	1.5%	2.7%	1.8%			
Other debt ⁽¹⁾	—	12,009	977	3,995	5,210	8,614	30,805	25,957
Effective yield		2.9%	2.5%	1.9%	3.8%			
Subordinated debentures	—	44	—	1,350	500	139	2,033	2,017
Effective yield		0.7%	—	5.0%	4.7%			
Acceptances and other liabilities	5,790	9,249	—	1	77	8,353	23,470	22,517
Shareholders' equity	—	400	—	689	—	6,119	7,208	6,477
	8,905	57,291	15,484	27,198	6,733	29,690	145,301	132,138
On-balance sheet gap	(986)	(5,127)	(44)	(7,836)	3,064	10,929	—	—
Derivative financial instruments	—	1,003	7,474	(8,711)	234	—	—	—
Total	(986)	(4,124)	7,430	(16,547)	3,298	10,929	—	—
Position in Canadian dollars								
On-balance sheet total	(2,916)	1,710	3,118	(8,675)	2,161	8,247	3,645	6,864
Derivative financial instruments	—	(4,868)	7,053	(4,434)	680	—	(1,569)	(50)
Total	(2,916)	(3,158)	10,171	(13,109)	2,841	8,247	2,076	6,814
Position in foreign currency								
On-balance sheet total	1,930	(6,837)	(3,162)	839	903	2,682	(3,645)	(6,864)
Derivative financial instruments	—	5,871	421	(4,277)	(446)	—	1,569	50
Total	1,930	(966)	(2,741)	(3,438)	457	2,682	(2,076)	(6,814)
Total 2010	(986)	(4,124)	7,430	(16,547)	3,298	10,929	—	—
Total 2009	(1,812)	(6,092)	9,721	(2,928)	2,141	(1,030)	—	—

(1) Obligations related to securities sold short and securities sold under repurchase agreements.

The effective yield represents the weighted average effective yield based on the earlier of contractual repricing and maturity dates.

NOTE 31

RELATED PARTY TRANSACTIONS

The Bank grants loans to its directors and officers under various conditions. The following table shows the balance of these granted loans as of:

	October 31, 2010	July 31, 2009
Other loans	48	39

Loans to eligible officers are granted under the same conditions as those applicable to loans granted to any other employee of the Bank. The principal conditions are as follows: the employee must meet the same credit requirements as a client; mortgage loans are granted at the posted rate less 2%; personal loans bear interest at the client rate divided by two; credit card advances bear interest at a prescribed fixed rate in accordance with Bank policy; and personal lines of credit bear interest at the Canadian prime rate less 3%, but never lower than Canadian prime divided by two.

For personal loans and personal lines of credit, employees may not borrow more than 50% of their annual gross salary at the reduced rate. The Canadian prime rate is applied to the remainder.

Moreover, in accordance with the *Bank Act* (Canada), the aggregate of loans granted to an officer of the Bank, excluding a mortgage loan granted on the officer's principal residence, cannot exceed two times the officer's base salary.

In the normal course of business, the Bank provides various banking services and concludes contractual agreements and other transactions with companies over which it has significant influence as well as with directors and officers under conditions similar to those offered to non-related third parties. These agreements did not have a significant impact on the Bank's results.

Furthermore, the Bank offers the Deferred Stock Unit Plan to directors who are not Bank employees. For additional information, see Note 24 of the consolidated financial statements.

NOTE 32

SEGMENT DISCLOSURES

The Bank carries out its activities in three operating segments, as defined below. The other operating activities are grouped for presentation purposes. Each reportable segment is distinguished by services offered, type of clientele and marketing strategy. The operations of each of the Bank's reportable segments are summarized below.

Personal and Commercial

The Personal and Commercial segment comprises the branch network, intermediary services, credit cards, insurance, business banking services and real estate.

Wealth Management

The Wealth Management segment comprises full-service retail brokerage, direct brokerage, mutual funds, trust services and portfolio management.

Financial Markets

The Financial Markets segment encompasses corporate financing and lending, trading activities, treasury operations, including asset and liability management for the Bank, and corporate brokerage.

Other

This heading comprises securitization transactions, certain non-recurring elements, and the unallocated portion of corporate services.

NOTE 32 SEGMENT DISCLOSURES (cont.)

The accounting policies are the same as those presented in Note 1, with the exception of the net interest income, other income and income taxes of the operating segments, which are presented on a taxable equivalent basis. Taxable equivalent basis is a calculation method that consists in grossing up certain tax-exempt income by the amount of income tax that would have otherwise been payable. The impact of these adjustments is reversed under the *Other* heading. Head Office expenses are allocated to each operating segment presented in the segmented results. The Bank assesses performance based on net income. Intersegment revenues are recognized at the exchange amount. Segment assets correspond to average assets directly used in segment operations.

Results by business segment

Year ended October 31	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
	Personal and Commercial		Wealth Management		Financial Markets		Other		Total	
Net interest income ⁽¹⁾	1,511	1,407	108	127	824	790	(531)	(358)	1,912	1,966
Other income ⁽¹⁾	915	880	661	630	565	640	225	15	2,366	2,165
Total revenues	2,426	2,287	769	757	1,389	1,430	(306)	(343)	4,278	4,131
Operating expenses	1,383	1,356	604	588	707	664	117	54	2,811	2,662
Contribution	1,043	931	165	169	682	766	(423)	(397)	1,467	1,469
Provision for credit losses	207	214	—	—	2	27	(65)	64	144	305
Income (loss) before income taxes (recovery) and non-controlling interests	836	717	165	169	680	739	(358)	(461)	1,323	1,164
Income taxes (recovery) ⁽¹⁾	249	235	52	53	199	227	(279)	(263)	221	252
Non-controlling interests	—	—	3	3	10	(1)	55	56	68	58
Net income (loss)	587	482	110	113	471	513	(134)	(254)	1,034	854
Average assets	60,671	56,070	940	873	92,990	97,805	(14,243)	(13,770)	140,358	140,978

(1) *Net interest income* was grossed up by \$206 million (\$129 million in 2009) and *Other income* was grossed up by a negligible amount (\$19 million in 2009). An equivalent amount was added to income taxes (recovery). The effect of these adjustments is reversed under the *Other* heading.

Results by geographic segment

Year ended October 31	2010	2009	2010	2009	2010	2009	2010	2009
	Canada		United States		Other		Total	
Net interest income	1,911	1,913	—	54	1	(1)	1,912	1,966
Other income	2,109	2,083	160	5	97	77	2,366	2,165
Total revenues	4,020	3,996	160	59	98	76	4,278	4,131
Operating expenses	2,598	2,477	150	122	63	63	2,811	2,662
Contribution	1,422	1,519	10	(63)	35	13	1,467	1,469
Provision for credit losses	149	295	(5)	10	—	—	144	305
Income (loss) before income taxes (recovery) and non-controlling interests	1,273	1,224	15	(73)	35	13	1,323	1,164
Income taxes (recovery)	219	252	3	—	(1)	—	221	252
Non-controlling interests	67	74	3	—	(2)	(16)	68	58
Net income (loss)	987	898	9	(73)	38	29	1,034	854
Average assets	130,477	130,130	7,288	5,848	2,593	5,000	140,358	140,978

PRINCIPAL SUBSIDIARIES

Name	Principal office address ⁽¹⁾	Voting and participating shares	Investment at carrying value ⁽²⁾ (millions of dollars)
National Bank Acquisition Holding Inc.	Montreal, Canada	100%	2,808
National Bank Life Insurance Company	Montreal, Canada	100%	
National Bank Insurance Firm Inc.	Montreal, Canada	100%	
1261095 Ontario Limited	Toronto, Canada	100%	
National Bank Group Inc.	Montreal, Canada	100%	
National Bank Financial & Co. Inc.	Montreal, Canada	100%	
Natcan Insurance Company Limited	Bridgetown, Barbados	100%	
Natcan Trust Company	Montreal, Canada	100%	
FMI Acquisition Inc.	Montreal, Canada	100%	186
National Bank Trust Inc.	Montreal, Canada	100%	155
CABN Investments Inc.	Montreal, Canada	100%	1
Natcan Acquisition Holdings Inc.	Montreal, Canada	100%	288
National Bank Securities Inc.	Montreal, Canada	100%	
9130-1564 Quebec Inc.	Montreal, Canada	57%	
Natcan Investment Management Inc.	Montreal, Canada	71%	
National Bank Direct Brokerage Inc.	Montreal, Canada	100%	
Innocap Investment Management Inc.	Montreal, Canada	75%	3
3562719 Canada Inc.	Montreal, Canada	100%	3
National Bank Realty Inc.	Montreal, Canada	100%	33
Assurances générales Banque Nationale (Gestion) Inc.	Montreal, Canada	90%	29
National Bank General Insurance Inc.	Montreal, Canada	90%	
Natcan Global Holdings Ltd.	Sliema, Malta	100%	512
NatBC Holding Corporation	Florida, United States	100%	15
Natbank, National Association	Florida, United States	100%	
NBC Trade Finance Limited	Hong Kong, China	100%	1
NBC Alternative Investments Inc.	Montreal, Canada	100%	6
NBC Asset Trust	Montreal, Canada	100%	296
NBC Financial Services Inc.	Montreal, Canada	100%	1

COMPANIES SUBJECT TO SIGNIFICANT INFLUENCE

Name	Principal office address ⁽¹⁾	Voting and participating shares	Investment at carrying value ⁽²⁾ (millions of dollars)
Maple Financial Group Inc.	Toronto, Canada	24.6%	143
PI Financial Corp.	Vancouver, Canada	25.0%	6

(1) All the subsidiaries are incorporated under the laws of the province, or under the laws of the state or country in which their principal office is located, except for NatBC Holding Corporation, which is incorporated under the laws of the State of Delaware, USA.

(2) The carrying value as at October 31, 2010 is based on the equity method.

STATISTICAL REVIEW

As at October 31	2010	2009	2008	2007	2006	2005	2004	2003	2002	2001
Consolidated Balance Sheet data										
(millions of dollars)										
Cash and deposits with financial institutions	2,274	2,228	3,660	3,328	10,879	10,314	5,777	7,047	6,864	5,832
Securities	54,268	50,233	46,185	39,270	38,678	33,052	28,007	26,179	20,118	17,872
Securities purchased under reverse repurchase agreements	10,878	7,637	7,868	5,966	7,592	7,023	4,496	3,955	2,366	4,041
Loans	57,188	52,637	51,741	47,960	46,945	44,069	41,498	38,381	38,446	40,351
Customers' liability under acceptances	5,946	5,733	4,274	4,085	3,725	3,242	3,076	3,334	2,988	3,593
Premises and equipment and other assets	14,747	13,670	15,604	12,476	8,982	10,270	5,643	5,730	5,249	4,277
Total assets	145,301	132,138	129,332	113,085	116,801	107,970	88,497	84,626	76,031	75,966
Deposits	81,785	75,170	76,022	70,798	71,917	62,219	53,432	51,463	51,690	51,436
Other liabilities and non-controlling interests	54,275	48,474	45,546	36,045	38,647	40,052	29,453	27,550	18,848	18,767
Subordinated debentures	2,033	2,017	2,255	1,605	1,449	1,102	1,408	1,516	1,592	1,647
Capital stock										
Preferred	1,089	1,089	774	400	400	400	375	375	300	492
Common	1,804	1,729	1,656	1,575	1,566	1,565	1,545	1,583	1,639	1,668
Contributed surplus	66	48	31	32	21	13	7	2	–	–
Retained earnings	4,081	3,515	3,110	2,793	2,893	2,645	2,287	2,131	1,945	1,937
Accumulated other comprehensive income (loss)	168	96	(62)	(163)	(92)	(26)	(10)	6	17	19
Total liabilities and shareholders' equity	145,301	132,138	129,332	113,085	116,801	107,970	88,497	84,626	76,031	75,966
Average assets	140,358	140,978	128,319	125,964	106,192	90,794	78,553	71,810	69,292	69,197
Average capital funds ⁽¹⁾	7,779	7,198	6,416	5,840	5,568	5,268	5,238	5,216	5,249	5,020
Consolidated Income Statement data										
(millions of dollars)										
Net interest income	1,912	1,966	1,852	1,116	1,284	1,441	1,363	1,311	1,444	1,338
Other income	2,366	2,165	1,785	2,301	2,511	2,226	2,155	2,033	1,584	1,789
Total revenues	4,278	4,131	3,637	3,417	3,795	3,667	3,518	3,344	3,028	3,127
Provision for credit losses	144	305	144	103	77	33	86	177	490	205
Operating expenses	2,811	2,662	2,695	2,626	2,538	2,463	2,361	2,239	2,040	1,989
Income taxes	221	252	167	79	277	291	318	277	150	278
Non-controlling interests	68	58	(145)	68	32	25	28	27	30	28
Income before discontinued operations and goodwill charges	1,034	854	776	541	871	855	725	624	318	627
Discontinued operations	–	–	–	–	–	–	–	–	111	(45)
Goodwill charges	–	–	–	–	–	–	–	–	–	19
Net income	1,034	854	776	541	871	855	725	624	429	563

As at October 31	2010	2009	2008	2007	2006	2005	2004	2003	2002	2001
Number of common shares (thousands)	162,772	161,201	159,447	157,806	161,512	165,335	167,430	174,620	182,596	190,331
Number of common shareholders of record	23,598	23,970	24,354	24,780	25,531	26,235	26,961	27,865	28,549	29,766
Earnings per share before goodwill charges – Basic	\$ 5.99	\$ 4.96	\$ 4.69	\$ 3.25	\$ 5.22	\$ 4.98	\$ 4.10	\$ 3.37	\$ 2.18	\$ 2.88
Earnings per share – Diluted	\$ 5.94	\$ 4.94	\$ 4.67	\$ 3.22	\$ 5.13	\$ 4.90	\$ 4.05	\$ 3.34	\$ 2.18	\$ 2.78
Dividend per share	\$ 2.48	\$ 2.48	\$ 2.48	\$ 2.28	\$ 1.96	\$ 1.72	\$ 1.42	\$ 1.08	\$ 0.93	\$ 0.82
Stock trading range										
High	\$ 67.87	\$ 62.08	\$ 54.63	\$ 66.59	\$ 65.60	\$ 61.47	\$ 48.78	\$ 41.19	\$ 34.93	\$ 31.00
Low	\$ 54.45	\$ 25.62	\$ 42.25	\$ 50.50	\$ 56.14	\$ 46.39	\$ 40.17	\$ 29.95	\$ 24.70	\$ 23.00
Close	\$ 67.13	\$ 56.39	\$ 45.21	\$ 54.65	\$ 61.25	\$ 59.14	\$ 48.78	\$ 40.91	\$ 29.39	\$ 24.25
Book value	\$ 37.59	\$ 33.43	\$ 29.70	\$ 26.85	\$ 27.17	\$ 25.39	\$ 22.87	\$ 21.32	\$ 19.72	\$ 19.04
Dividends on preferred shares										
Series 10	-	-	-	-	-	-	-	-	-	\$ 2.1875
Series 11	-	-	-	-	-	-	-	-	\$ 0.5000	\$ 2.0000
Series 12	-	-	-	-	-	-	-	\$ 0.8125	\$ 1.6250	\$ 1.6250
Series 13	-	-	-	-	-	\$ 1.2000	\$ 1.6000	\$ 1.6000	\$ 1.6000	\$ 1.6000
Series 15	\$ 1.4625	\$ 1.4625	\$ 1.4625	\$ 1.4625	\$ 1.4625	\$ 1.4625	\$ 1.4625	\$ 1.1480	-	-
Series 16	\$ 1.2125	\$ 1.2125	\$ 1.2125	\$ 1.2125	\$ 1.2125	\$ 0.8089	-	-	-	-
Series 20	\$ 1.5000	\$ 1.5000	\$ 0.8692	-	-	-	-	-	-	-
Series 21	\$ 1.3438	\$ 1.3438	\$ 0.5596	-	-	-	-	-	-	-
Series 24	\$ 1.6500	\$ 1.3765	-	-	-	-	-	-	-	-
Series 26	\$ 1.6500	\$ 1.3042	-	-	-	-	-	-	-	-
Financial ratios										
Return on common shareholders' equity										
before goodwill charges	17.0%	15.6%	16.4%	11.5%	20.1%	20.7%	18.8%	16.5%	11.3%	16.0%
Return on average assets	0.72%	0.61%	0.60%	0.43%	0.82%	0.94%	0.92%	0.87%	0.62%	0.80%
Return on average capital funds	13.3%	11.9%	12.1%	9.3%	15.6%	16.2%	13.8%	11.9%	9.5%	12.5%
Capital ratios – BIS ⁽²⁾										
Tier 1	14.0%	10.7%	9.4%	9.0%	9.9%	9.6%	9.6%	9.6%	9.6%	9.6%
Total	17.5%	14.3%	13.2%	12.4%	14.0% ⁽³⁾	12.8% ⁽⁴⁾	13.0%	13.4%	13.6%	13.1%
Other information										
Impaired loans (millions of dollars)	\$ 162	\$ 223	\$ 169	\$ 129	\$ 116	\$ 117	\$ 160	\$ 251	\$ 246	\$ 591
Number of employees ⁽⁵⁾	15,298	14,851	14,420	14,484	14,381	14,372	14,122	14,328	14,589	14,321
Branches in Canada	442	445	446	447	451	457	462	477	507	525
Banking machines	869	866	858	836	801	788	770	817	826	834

(1) Average capital funds include common shareholders' equity, redeemable preferred shares and subordinated debentures.

(2) In 2008, the Bank adopted the rules of the Basel II Accord and, since November 1, 2009, it has been applying the Advanced Internal Rating-Based Approach for credit risk, whereas prior to that date, it had been using the Standardized Approach. Under Basel I for 2007 and years prior.

(3) Taking into account the issuance of \$500 million of subordinated debentures on November 2, 2006.

(4) Taking into account the issuance of \$500 million of subordinated debentures on November 2, 2005.

(5) In full-time equivalent.

INFORMATION FOR SHAREHOLDERS

DESCRIPTION OF SHARE CAPITAL

The authorized share capital of the Bank consists of an unlimited number of common shares, without par value, an unlimited number of first preferred shares, without par value, issuable for a maximum aggregate consideration of \$5 billion; and 15 million second preferred shares, without par value, issuable for a maximum aggregate consideration of \$300 million. As at October 31, 2010, the Bank had a total of 162,771,816 common shares and 43,550,000 first preferred shares issued and outstanding.

STOCK EXCHANGE LISTINGS

The common shares of the Bank and the First Preferred Shares, Series 15, 16, 20, 21, 24, and 26 are listed on the Toronto Stock Exchange.

Issue or class	Ticker symbol	Newspaper abbreviation
Common Shares	NA	Nat Bk or Natl Bk
First Preferred Shares		
Series 15	NA.PR.K	Nat Bk s15 or Natl Bk s15
Series 16	NA.PR.L	Nat Bk s16 or Natl Bk s16
Series 20	NA.PR.M	Nat Bk s20 or Natl Bk s20
Series 21	NA.PR.N	Nat Bk s21 or Natl Bk s21
Series 24	NA.PR.O	Nat Bk s24 or Natl Bk s24
Series 26	NA.PR.P	Nat Bk s26 or Natl Bk s26

NUMBER OF REGISTERED SHAREHOLDERS

As at October 31, 2010, there were 23,598 common shareholders recorded in the Bank's common share register.

DIVIDENDS

Dividend dates in 2011

(subject to approval by the Board of Directors of the Bank)

Ex-dividend date	Record date	Payment date
Common Shares		
December 21, 2010	December 23, 2010	February 1, 2011
March 22, 2011	March 24, 2011	May 1, 2011
June 21, 2011	June 23, 2011	August 1, 2011
September 20, 2011	September 22, 2011	November 1, 2011
Preferred Shares, Series 15, 16, 20, 21, 24 and 26		
January 5, 2011	January 7, 2011	February 15, 2011
April 6, 2011	April 8, 2011	May 15, 2011
July 6, 2011	July 8, 2011	August 15, 2011
October 5, 2011	October 7, 2011	November 15, 2011

Dividends declared on common shares during 2010

Ex-dividend date	Record date	Payment date	Dividend per share (\$)
December 22, 2009	December 24, 2009	February 1, 2010	0.62
March 23, 2010	March 25, 2010	May 1, 2010	0.62
June 21, 2010	June 23, 2010	August 1, 2010	0.62
September 21, 2010	September 23, 2010	November 1, 2010	0.62

Dividends declared on preferred shares during 2010

Ex-dividend date	Record date	Payment date	Dividend per share (\$)					
			Series 15	Series 16	Series 20	Series 21	Series 24	Series 26
Jan. 6, 2010	Jan. 8, 2010	Feb. 15, 2010	0.365625	0.303125	0.375	0.33594	0.4125	0.4125
Apr. 7, 2010	Apr. 9, 2010	May 15, 2010	0.365625	0.303125	0.375	0.33594	0.4125	0.4125
Jul. 7, 2010	Jul. 9, 2010	Aug. 15, 2010	0.365625	0.303125	0.375	0.33594	0.4125	0.4125
Oct. 6, 2010	Oct. 8, 2010	Nov. 15, 2010	0.365625	0.303125	0.375	0.33594	0.4125	0.4125

Dividends paid are "eligible dividends" in accordance with the *Income Tax Act* (Canada).

DIVIDEND REINVESTMENT AND SHARE PURCHASE PLAN

National Bank has a dividend reinvestment and share purchase plan for Canadian holders of its common and preferred shares under which they can acquire common shares in the Bank without paying commissions or administration fees. Participants acquire shares through the reinvestment of cash dividends paid on the shares they hold or through optional cash payments of at least \$500 per payment, up to a maximum of \$5,000 per quarter.

For more information, shareholders may contact National Bank's registrar and transfer agent, Computershare Trust Company of Canada, at 1-888-838-1407. To participate in the plan, National Bank's beneficial or non-registered common shareholders must contact their financial institution or broker.

Direct Deposit

Shareholders may elect to have their dividend payments deposited directly via electronic funds transfer to their bank account at any financial institution that is a member of the Canadian Payments Association. To do so, they must send a written request to the Transfer Agent, Computershare Trust Company of Canada.

Head Office

National Bank of Canada
National Bank Tower
600 De La Gauchetière Street West, 4th Floor
Montreal, Quebec H3B 4L2 Canada

Telephone: 514-394-5000

Website: www.nbc.ca

Annual Meeting

The Annual Meeting of Holders of Common Shares of the Bank will be held on Wednesday, March 30, 2011, at the Centre Mont-Royal in Montreal, Quebec, Canada.

Public Accountability Statement

The 2010 Social Responsibility Report will be available in March 2011 on the Bank's website at www.nbc.ca.

Communication with Shareholders

For information about stock transfers, address changes, dividends, lost certificates, tax forms and estate transfers, shareholders of record may contact the Transfer Agent at the following address:

Computershare Trust Company of Canada

Share Ownership Management
1500 University Street, 7th Floor
Montreal, Quebec H3A 3S8 Canada

Telephone: 1-888-838-1407

Fax: 1-888-453-0330

E-mail: service@computershare.com

Website: www.computershare.com

Shareholders whose shares are held by a market intermediary are asked to contact the market intermediary concerned.

Other shareholder inquiries can be addressed to:

Investor Relations

National Bank Financial Group

National Bank Tower

600 De La Gauchetière Street West, 7th Floor

Montreal, Quebec H3B 4L2 Canada

Telephone: 1-866-517-5455

Fax: 514-394-6196

E-mail: investorrelations@nbc.ca

Website: www.nbc.ca/investorrelations

Caution Regarding Forward-Looking Statements

From time to time, National Bank of Canada makes written and oral forward-looking statements, included in this Annual Report, in other filings with Canadian regulators, in reports to shareholders, in press releases and in other communications. All such statements are made pursuant to the Canadian and American securities legislation and the provisions of the United States *Private Securities Litigation Reform Act of 1995*.

Additional information relative to these statements can be found on pages 18 to 21 of this Annual Report.

Trademarks

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